92-108

No. ——

Supreme Court, U.S.
FILED
JUL 16 1992
OFFICE OF THE CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

BRYSON PROPERTIES, XVIII,
Petitioner

v.

THE TRAVELERS INSURANCE COMPANY,
Respondent

Petition for Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

---

PETITION FOR WRIT OF CERTIORARI

JOHN A. NORTHEN
Counsel of Record
JO ANN RAGAZZO WOODS
Post Office Box 2208
Chapel Hill, NC 27515-2208
(919) 968-4441

WILLIAM P. MILLER
Post Office Box 1550
High Point, NC 27261
(919) 889-8733
Counsel for Petitioner

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

78

QUESTIONS PRESENTED

1. Whether the Court of Appeals for the Fourth Circuit erred by refusing to allow a debtor, proposing a plan of reorganization in good faith, the latitude in classification of claims provided by the express language of 11 U.S.C. § 1122(a), and by creating the requirement that all unsecured claims must be classified together where no such requirement exists in the Bankruptcy Code.

2. Whether the Court of Appeals for the Fourth Circuit erred by holding that the longstanding bankruptcy doctrine called the fresh or new capital exception to the absolute priority rule, established by this Court in *Case v. Los Angeles Lumber Co.*, 308 U.S. 106 (1939), was no longer viable after enactment of the Bankruptcy Code, an issue that was expressly left unanswered by this Court in *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988) and that has sharply divided the lower courts.

LIST OF PARTIES

The parties to the proceedings below were petitioner Bryson Properties, XVIII (debtor and defendant-appellee) and respondent The Travelers Insurance Company (plaintiff-appellant). The petitioner is not a corporation.

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
LIST OF PARTIES	ii
OPINIONS BELOW	1
JURISDICTION	2
STATUTES INVOLVED	3
STATEMENT OF THE CASE	3
REASONS FOR GRANTING THE WRIT	8
I. THE BANKRUPTCY ISSUES RAISED IN THIS CASE ARE RECURRING QUESTIONS OF IMPORTANCE TO THE ADMINISTRATION OF CHAPTER 11 CASES WITH TWO CONFLICTING APPROACHES TAKEN BY THE LOWER COURTS BASED ON OPPOSING VIEWS OF THE BANKRUPTCY CODE	8
II. REVIEW BY THE SUPREME COURT IS NECESSARY TO PROVIDE UNIFORM STANDARDS FOR CLASSIFICATION OF CLAIMS AND TO RESOLVE CONFLICT AMONG THE CIRCUITS	14
III. SUPREME COURT DECISION ON THE CONTINUING VIABILITY OF THE "NEW CAPITAL EXCEPTION" TO THE ABSOLUTE PRIORITY RULE IS NECESSARY TO RESOLVE THE ISSUE LEFT UNANSWERED IN *AHLERS* AND TO RESOLVE CONFLICT SO PREVALENT IN THE LOWER COURTS SINCE ENACTMENT OF THE BANKRUPTCY CODE	21
CONCLUSION	30

TABLE OF CONTENTS—Continued

Page

APPENDIX

Opinion and judgment of the United States Court of Appeals for the Fourth Circuit 1a

Opinion and judgment of the United States District Court for the Middle District of North Carolina 17a

Order of the United States Bankruptcy Court for the Middle District of North Carolina 37a

TABLE OF AUTHORITIES

CASES: Page

In re Ag Consultants Grain Division, Inc., 77 Bankr. 665 (Bankr. N.D. Ind. 1987) 10, 17, 18
Anderson v. Farm Credit Bank of St. Paul, 913 F.2d 530 (8th Cir. 1990) 9, 25
In re Aztec Co., 107 Bankr. 585 (Bankr. M.D.Tenn. 1989) 9, 17
Barnes v. Whelan, 689 F.2d 193 (D.C. Cir. 1982) .. 9, 17
In re Bjolmes Realty Trust, 134 Bankr. 1000 (Bankr. Mass. 1991) 9, 10, 13, 17, 18, 21, 26
In re Blankemeyer, 861 F.2d 192 (8th Cir. 1988) .. 25
In re Cantonwood Associates L.P., 138 Bankr. 648 (Bankr. Mass. 1992) 17
Case v. Los Angeles Lumber Co., 308 U.S. 106 (1939) 22
Granada Wines, Inc. v. New England Teamsters and Trucking Industry Pension Fund, 748 F.2d 42 (1st Cir. 1984) 8, 17
In re Green, 98 Bankr. 981 (9th Cir. BAP 1989) 9
In Matter of Jersey City Medical Center, 817 F.2d 1055 (3rd Cir. 1987) 9, 17
Kham & Nate's Shoes No. 2 v. First Bank of Whiting, 908 F.2d 1351 (7th Cir. 1990) 8, 28
Lumber Exchange Building Lmt. Partnership v. Mutual Life Ins. Co. of NY, 134 Bankr. 354 (D. Minn. 1991) 9
Norwest Bank Worthington v. Ahlers, 485 U.S. 197 (1988) 21, 22
In re Outlook/Century Ltd., 127 Bankr. 650 (Bankr. N.D.Cal. 1991) 9, 10, 27
Penn Mutual Life Ins. Co. v. Woodscape L.P., 134 Bankr. 165 (Bankr. Md. 1991) 9, 10, 26
In re Perdido Motel Group, Inc., 101 Bankr. 289, 294 (Bankr. N.D.Ala. 1989) 14
Phoenix Mutual Life Insurance Co. v. Greystone III Joint Venture, 102 Bankr. 560 (Bankr. W.D. Tex. 1989), *rev'd*, 948 F.2d 134 (5th Cir. 1991) .. 17
Phoenix Mutual Life Insurance Co. v. Greystone III Joint Venture, 948 F.2d 134 (5th Cir. 1991), *withdrawn in part on rehearing* (1992) 8, 9, 14, 18, 28

TABLE OF AUTHORITIES—Continued

	Page
Piedmont Associates v. Cigna Property & Casualty Ins. Co., 132 Bankr. 75 (N.D.Ga. 1991)	9
In re Pine Gate Associates, Ltd., 2 Bankr. Ct. Dec. 1478 (N.D.Ga. 1976)	11
In re Potter Material Service, Inc., 781 F.2d 99 (7th Cir. 1986)	28
In re Stegall, 865 F.2d 140 (7th Cir. 1989)	28
In re Snyder, 99 Bankr. 885 (Bankr. N.D. Ill. 1989)	28
In re Tallahassee Associates, L.P., 132 Bankr. 712 (Bankr. W.D. Pa. 1991)	26, 27
Teamsters National Freight Industry Negotiating Comm. v. U.S. Truck Co., Inc., 800 F.2d 581 (6th Cir. 1986)	9, 16, 25
Travelers Insurance Co. v. Bryson Properties XVIII, 129 Bankr. 440 (M.D.N.C.), *rev'd*, 961 F.2d 496 (4th Cir. 1992)	24
Travelers Insurance Co. v. Bryson Properties, XVIII, 961 F.2d 496 (4th Cir. 1992)	8, 13, 15, 23
In re Triple R Holdings L.P., 134 Bankr. 382 (Bankr. N.D.Cal. 1991)	9, 10, 11, 26, 27
In re 222 Liberty Associates, 108 Bankr. 971 (Bankr. E.D.Pa. 1990)	9, 10
United Savings Association of Texas v. Timbers of Inwood Forest Assoc. Ltd., 484 U.S. 365 1988)	5
In re Winters, 99 Bankr. 658 (Bankr. W.D.Pa. (1989)	9, 14, 27

STATUTES:

11 U.S.C. Section 102(3)	26
11 U.S.C. Section 506	4
11 U.S.C. Section 506(a)	5, 11, 15
11 U.S.C. Section 1111(b)	5, 11, 12, 24
11 U.S.C. Section 1121(b)	23
11 U.S.C. Section 1122(a)	3, 14, 16, 17
11 U.S.C. Section 1124	7, 13
11 U.S.C. Section 1126(c)	7, 20
11 U.S.C. Section 1126(d)	19

TABLE OF AUTHORITIES—Continued

	Page
11 U.S.C. Section 1126(f)	7
11 U.S.C. Section 1129	7
11 U.S.C. Section 1129(a)(10)	13, 14
11 U.S.C. Section 1129(a)(7)(ii)	19
11 U.S.C. Section 1129(b)	7, 10, 11, 20
11 U.S.C. Section 1129(b)(1)	7
11 U.S.C. Section 1129(b)(2)	26
11 U.S.C. Section 1129(b)(2)(B)	3, 20
28 U.S.C. Section 157(a)	2
28 U.S.C. Section 157(b)(1)	2
28 U.S.C. Section 158(a)	2
28 U.S.C. Section 1254(1)	2
28 U.S.C. Section 1291	2
28 U.S.C. Section 1334(a)	2

OTHER AUTHORITY:

Baird & Jackson, *Bargaining After the Fall and the Contours of the Absolute Priority Rule*, 55 Univ.Chi.L.Rev. 738 (1988)	29
Blair, *Classification of Unsecured Claims in Chapter 11 Reorganization*, 58 Am. Bankr. L.J. 197 (1984)	16
5 *Collier on Bankruptcy* Section 1111.02 (15th ed. 1991)	11
5 *Collier on Bankruptcy* Section 1111.02, 1111-14 (15th ed. 1991)	11, 12
Epling, *The New Value Exception: Is There a Practical, Workable Solution?*, 2 Bankr.Dev.J. 335 (1991)	29
H.R.Rep. No. 95-595, 95th Cong., 1st Sess. 406 (1977)	16
Klee, *Cram Down II*, 64 Am. Bankr. L.J. 229 (1990)	29
Klee, *Everything You Always Wanted to Know About Cram Down Under the Code*, 53 Am. Bankr. L.J. 133 (1979)	12
Markell, *Owners, Auctions and Absolute Priority in Bankruptcy Reorganization*, 44 Stan.L.Rev. 69 (1991)	29

TABLE OF AUTHORITIES—Continued

Page

Nimmer, *Negotiated Bankruptcy Reorganization Plans: Absolute Priority and New Value Contribution*, 36 Emory L.J. 1009 (1987) 26

Peeples, *Staying In: Chapter 11, Close Corporations and The Absolute Priority Rule*, 63 Am. Bankr.L.J. 65 (1989) 22, 29

Scott, *Sharing the Risks of Bankruptcy: Timbers, Ahlers and Beyond*, 1 Colum.Bus.L.Rev. 183 (1989) 29

Skeel, *The Uncertain State of an Unstated Rule: Bankruptcy's Contribution Rule Doctrine After Ahlers*, 63 Am. Bank.L.J. 221 (1989) 29

S.Rep. No. 95-989, 95th Cong., 2d Sess. 118 (1978) 16

Vihon, *Classification of Unsecured Claims: Squaring a Circle?*, 55 Am. Bankr. L.J. 143 (1981) 16

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

No. ———

BRYSON PROPERTIES, XVIII,
Petitioner

v.

THE TRAVELERS INSURANCE COMPANY,
Respondent

Petition for Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

---

PETITION FOR WRIT OF CERTIORARI

The petitioner Bryson Properties XVIII respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Fourth Circuit, entered in this case on April 20, 1992.

OPINIONS BELOW

The opinion of the Court of Appeals for the Fourth Circuit is reported at 961 F.2d 496 and is reprinted in the appendix hereto, p. 1a, *infra*.

The memorandum opinion and judgment of the United States District Court for the Middle District of North Carolina is reported at 129 Bankr. 440 and is reprinted in the appendix hereto, p. 17a, *infra*.

The order of the United States Bankruptcy Court confirming the plan of reorganization is not reported but is reprinted in the appendix hereto, p. 37a, *infra*.

JURISDICTION

Pursuant to 28 U.S.C. § 1334(a), the district court has original and exclusive jurisdiction of all cases under Title 11. In accordance with 28 U.S.C. § 157(a), the United States District Court for the Middle District of North Carolina issued Standing Order #10 on August 15, 1984 referring all cases under Title 11 to the bankruptcy judges in this judicial district. By the authority in 28 U.S.C. § 157(b)(1), the Honorable Jerry G. Tart, Bankruptcy Judge, entered an order confirming the debtor's third amended plan of reorganization on June 26, 1990. Appendix (hereinafter referred to as Ap.) 37a.

Invoking 28 U.S.C. § 158(a), respondent Travelers Insurance Company appealed the confirmation order to the United States District Court for the Middle District of North Carolina. On February 8, 1991, the Honorable Frank W. Bullock, Jr., District Judge, rendered an order and memorandum opinion affirming the decision of the bankruptcy judge. Ap. 17a.

Respondent further appealed to the United States Court of Appeals for the Fourth Circuit pursuant to 28 U.S.C. § 1291. The Court of Appeals entered judgment on April 20, 1992 reversing the decision of the district court and remanding the case to the bankruptcy court for further findings consistent therewith. Ap. 1a. No petition for rehearing was sought.

The jurisdiction of this Court to review the judgment of the court of appeals for the Fourth Circuit is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

11 U.S.C. Section 1122. Classification of claims or interests.

(a) Except as provided in subsection (b) of this section, a plan may place a claim or interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class.

11 U.S.C. Section 1129. Confirmation of plan.

(b)(1) Notwithstanding Section 510(a) of this title, if all of the applicable requirements of subsection (a) of this section other than paragraph (8) [acceptance by all impaired classes] are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.

(2) For purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:

(B) With respect to a class of unsecured claims—

(i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property.

STATEMENT OF THE CASE

Petitioner Bryson Properties XVIII (hereinafter referred to as "Bryson") is a limited partnership with the primary asset of three office buildings in Omaha, Ne-

braska known as Mid-America Plaza. Bryson purchased the office buildings in 1986 subject to a first mortgage in favor of respondent The Travelers Insurance Company ("Travelers"). The mortgage secures a 1985 non-recourse note in the face amount of $10.8 million dollars given to Travelers by the prior owner of the property.

Bryson made payment to Travelers for approximately three years, but began to face financial difficulty due to a number of factors. First, a major tenant of the offices buildings vacated the premises leaving 50,000 square feet of space unoccupied. Second, asbestos was discovered in all three buildings with costs estimated at $828,000.00 for its safe removal. Third, the commercial real estate market in Omaha was very "soft". Fourth, property taxes plus statutory penalties and interest were unpaid, and, finally, Bryson fell behind on payments to Travelers. Bryson made efforts to negotiate with Travelers, but Travelers refused and gave notice of its intent to accelerate the balance due and foreclose on the property. In September 1989, Bryson filed a petition pursuant to Chapter 11 of the Bankruptcy Code in an effort to reorganize.

In June 1990, the bankruptcy court confirmed Bryson's Third Amended Plan of Reorganization (the "Plan") after consideration of witness testimony, documentary evidence, arguments and briefs of counsel at four different hearings. Ap. 37a. The Plan classifies creditors' claims into eight classes. Classes 1 and 2 consisting of administrative and priority claims are not impaired. The remaining classes consisting of claims of governmental authorities, Travelers secured claim, and the unsecured claims of Travelers, Continental Bank, trade creditors and the partners are impaired by the treatment proposed in the Plan. The Plan is funded by contributions of the partners consisting of cash in the amount of $625,000.00 and a line of credit in the amount of $825,000.00.

Pursuant to 11 U.S.C. § 506, the Plan treats Travelers' claim ($11,234,306.00) as a Class 4 secured claim to the

extent of Bryson's interest in the property ($7,905,068.00) and the remainder ($3,329,238.00) as a Class 7 unsecured claim.[1] The Plan provides for Travelers to be paid on its Class 4 secured claim over ten years in monthly installments at increasing rates of interest average 9.79% over the life of the Plan. The total payments to Travelers under the Plan on this claim would equal $16,010,590.00.

The Plan further provides for several payments to be made on the effective date of the Plan from the cash contributions made by Bryson's partners. Payment of $170,000.00 was to be made toward the governmental claims in Class 3 with the balance of principal and statutory interest to be paid over several years. Payment was to be made to Travelers in the amount of three and one-half percent of its Class 7 unsecured deficiency claim in full satisfaction thereof unless Travelers makes an election pursuant to 11 U.S.C. § 1111(b). Similarly, the Class 5 and 6 unsecured claims were to receive three and one-half percent of their claims in cash. Class 5 and 6 claimants, however, should have the remainder of their claims paid in full outside of the Plan, as Bryson's general partner remains liable for the balance of the Class 6 claims under general partnership law and there is a personal guaranty by certain partners on the Class 5 claims. Travelers, on the other hand, has no recourse against any person or entity outside the Plan. The part-

---

[1] The Code bifurcates an under secured lender's claim pursuant to 11 U.S.C. § 506(a) and provides that the lender has a secured claim to the extent of the value of the estate's interest in the property and an unsecured claim for the deficiency. *See also United Savings Association of Texas v. Timbers of Inwood Forest Assoc. Ltd.*, 484 U.S. 365 (1988). The lender has a choice, however, to elect to have its entire claim treated as secured and receive a stream of payments of a principal face amount equal to the total amount of the debt and having a present value equal to the value of the collateral, all pursuant to 11 U.S.C. § 1111(b). If the election is made, there is no unsecured deficiency claim.

ners' claims in Class 8 receive no payment, but the partners, in consideration of their significant cash contributions, are permitted ownership of the reorganized entity.

In the event the property is sold or refinanced before the end of the ten year term, the Plan provides for proceeds to be paid as follows:

(a) $7,905,068.00 to Travelers as the outstanding principal balance of the secured claim;

(b) payment of the outstanding principal balance of the line of credit provided by the partners;

(c) payment of the new cash contribution of the partners of $625,000.00;

(d) payment to Travelers of any difference in the amount of the principal balance shown on the amortization schedule attached to the Plan (amortizing the original loan amount of $10.8 million at 5.25%) and the principal balance of the secured claim; and

(e) Travelers shares in any surplus funds distributable thereafter in an amount equal to 33.3%.[2]

---

[2] For example, on the effective date of the Plan, Travelers will be paid three and one-half percent of its unsecured claim or $116,523.33. During the following five years Travelers would receive interest payments on its secured claim totalling $3,695,619.12. If the property is sold after five years for $12 million dollars, payments would be made in the following order:

1. $7,905,068.00 to Travelers (principal balance, secured claim)
2. $ 850,000.00 to partners (line of credit principal balance)
3. $ 625,000.00 to partners for new cash contributions
4. $1,916,735.73 to Travelers, as the difference between amortized balance of original debt and the secured claim, as an additional dividend to Travelers
5. Remaining profit of $703,196.27 divided, with $232,054.77 paid to Travelers and balance to partners.

Thus, under this example Travelers would receive a total of $13,866,000.95 for its claims.

As all classes of claims, except Travelers, voted in favor of the Plan[3], Bryson requested the court to confirm over the objections of Travelers in accordance with the provisions of 11 U.S.C. Section 1129(b), commonly referred to as "cram down".[4] To invoke the "cram down" provisions, the requirements of Section 1129 (other than acceptance by all classes) must be fulfilled including that the Plan must be proposed in good faith, feasible, and accepted by at least one class of impaired claims. Further, the court must find that the Plan does not unfairly discriminate and is fair and equitable with respect to the dissenting class. Despite findings of good faith, feasibility, acceptance by three impaired classes, and compliance with all other provisions of Section 1129 as found by the bankruptcy court and the district court, the court of appeals held that Bryson impermissibly manipulated its classification of claims in the Plan to obtain confirmation. In a footnote, the court of appeals refused to recognize Class 3 governmental property tax claims as an impaired class that can accept a crammed down plan. The court then proceeded to find Bryson's placement of different unsecured claims into three classes "clearly for the purpose of manipulating voting". F.2d at 502, Ap. 11a. The court further ruled that the Plan violated the absolute priority rule as the partners were entitled to retain ownership in exchange for their con-

[3] If a class is not impaired (as defined in 11 U.S.C. Section 1124), the class is conclusively presumed to have accepted the plan. 11 U.S.C. Section 1126(f). If the class is impaired, acceptance of the plan by at least two-thirds in amount and more than one-half in number of the allowed claims is deemed acceptance. 11 U.S.C. Section 1126(c).

[4] 11 U.S.C. Section 1129(b)(1) provides in part that "if all of the applicable requirements of subsection (a) of this section other than (8) [acceptance by all impaired classes] are met with respect to the plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan."

siderable cash contributions to the Plan. Bryson seeks a writ of certiorari to review the decision of the court of appeals.

REASONS FOR GRANTING THE WRIT

I. THE BANKRUPTCY ISSUES RAISED IN THIS CASE ARE RECURRING QUESTIONS OF IMPORTANCE TO THE ADMINISTRATION OF CHAPTER 11 CASES WITH TWO CONFLICTING APPROACHES TAKEN BY THE LOWER COURTS BASED ON OPPOSING VIEWS OF THE BANKRUPTCY CODE.

This case presents important and recurring questions relating to the classification of claims in Chapter 11 reorganization plans and the standards to be applied in "cram down" confirmation proceedings.

B. *The Conflict Among and Within the Circuits*:

The Fourth Circuit has adopted a restrictive approach to the classification of unsecured claims and effectively eliminated the new value exception to the absolute priority rule, thereby severely limiting the availability of the cram down provisions as a means for a debtor to obtain confirmation of a plan of reorganization over a creditor's objection. *Travelers Insurance Co. v. Bryson Properties, XVIII*, 961 F.2d 496 (4th Cir. 1992), Ap. 1a. The Fifth Circuit has also embraced these restricted, limited, creditor oriented theories in *Phoenix Mutual Life Insurance Co. v. Greystone III Joint Venture*, 948 F.2d 134 (5th Cir. 1991) *withdrawn in part on rehearing* (1992). This creditor control orientation is also pervasive in the First and Seventh Circuits. *See Granada Wines, Inc. v. New England Teamsters and Trucking Industry Pension Fund*, 748 F.2d 42 (1st Cir. 1984); *Kham & Nate's Shoes No. 2 v. First Bank of Whiting*, 908 F.2d 1351 (7th Cir. 1990).

There is, however, an opposing view in the Third, Sixth, D.C. and Eighth Circuits which permits a debtor the flexibility in classification of claims contemplated by

the Bankruptcy Code and/or continues to recognize the viability of the new capital exception to the absolute priority rule as a longstanding and necessary part of bankruptcy law and practice. *See Barnes v. Whelan*, 689 F.2d 193 (D.C.Cir. 1982) (flexible classification); *Teamsters National Freight Industry Negotiating Comm. v. U.S. Truck Co., Inc.*, 800 F.2d 581 (6th Cir. 1986) (flexible classification and new value exception exists); *In Matter of Jersey City Medical Center*, 817 F.2d 1055 (3d Cir. 1987) (flexible classification); *Anderson v. Farm Credit Bank of St. Paul*, 913 F.2d 530 (8th Cir. 1990) (new value exception exists). *See also* "Reasons 2 and 3", *infra*, for detailed discussion on nature and extent of the differing positions on each issue.

These diametrically opposed approaches have even caused conflict within the various districts of circuits. *See In re Green*, 98 Bankr. 981 (9th Cir. BAP 1989) (recognizing new value exception to the absolute priority rule); *In re Triple R Holdings L.P.*, 134 Bankr. 382 (Bankr. N.D.Cal. 1991) (new value exception survives enactment of the Code). *Cf. In re Outlook/Century Ltd.*, 127 Bankr. 650 (Bankr. N.D.Cal. 1991) (no new value exception exists). *See also In re 222 Liberty Associates*, 108 Bankr. 971 (Bankr. E.D.Pa. 1990) (new value exception exists); *Cf. In re Winters*, 99 Bankr. 658 (Bankr. W.D.Pa. 1989) (no new value exception).

The present case as well as the vast majority of the cases involved in the split of authority are single asset real estate cases which involve this same combination of issues. *See e.g., Phoenix Mutual Life Insurance Co. v. Greystone III Joint Venture*, 948 F.2d 134 (5th Cir. 1991) *withdrawn in part on rehearing* (1992); *Piedmont Associates v. Cigna Property & Casualty Ins. Co.*, 132 Bankr. 75 (N.D.Ga. 1991); *Lumber Exchange Building Lmt. Partnership v. Mutual Life Ins. Co. of NY*, 134 Bankr. 354 (D. Minn. 1991); *Penn Mutual Life Ins. Co. v. Woodscape L.P.*, 134 Bankr. 165 (Bankr. Md. 1991); *In re Bjolmes Realty Trust*, 134 Bankr. 1000 (Bankr. Mass. 1991); *In re Aztec Co.*, 107 Bankr. 585 (Bankr.

M.D.Tenn. 1989); *In re 222 Liberty Associates*, 108 Bankr. 971 (Bankr. E.D.Pa. 1990); *In re Triple R Holdings L.P.*, 134 Bankr. 382 (Bankr. N.D. Cal. 1991); *In re AG Consultants Grain Division, Inc.*, 77 Bank. 665 (Bankr. N.D. Ind. 1987); *In re Outlook/Century Ltd.*, 127 Bankr. 650 (Bankr. N.D. Cal. 1991). These issues are central to many plans of reorganization and are particularly important in light of troubled real estate markets *In re Bjolmes Realty Trust*, 134 Bankr. 1000 (Bankr. Mass. 1991).

B. *Legislative History and Development; Balancing the Rights of Debtor and Secured Creditor in the Single-Asset Real Estate Case*:

The decision of these issues and the ensuing conflict among the lower courts referenced *supra* reflect the underlying philosophical differences of opinion on the purpose of Chapter 11 reorganization under the Bankruptcy Code and control of the process particularly in single asset real estate cases. The restrictive approach to classification and the refusal to give credence to the new value exception found in the Fourth Circuit and the other courts following this view are linked to the creditor control concept which these courts believe to be embodied in Chapter 11. There is, of course, a long history of creditor control in bankruptcy law, but the Bankruptcy Code enacted in 1978 made fundamental changes in the law by providing a debtor with some measure of control in reorganization such as the initial exclusive right to propose a plan, a unified Chapter 11 and the cram down provisions of Section 1129(b). *See Penn Mutual Life Ins. Co. v. Woodscape L.P.*, 134 Bankr. 165 (Bankr. Md. 1991) (excellent analysis of recent origins of debtor control in bankruptcy law and practice). The recognition of the debtor's right to participate in the reorganization process, the policy of negotiation, and development of consensual plans so fundamental to the new Code is the genus of the flexible approach and is the more appropriate manner in which to view the roles of the parties

and the courts in Chapter 11 reorganizations under the Code.

The legislative history of the Code reveals that the treatment of single asset real estate cases was a topic of concern and discussion. The law prior to enactment of the Code permitted a debtor to "write down" a secured debt to the value of the property while the real estate market was low. *See generally* 5 *Collier on Bankruptcy* § 1111.02 (15th ed. 1991). There was no Section 506(a) counterpart in the Act, no unsecured deficiency claim for the lender, and in several cases the debtor was permitted to retain the property and enjoy the future property appreciation. *See In re Pine Gate Associates, Ltd.*, 2 Bankr. Ct. Dec. 1478 (N.D.Ga. 1976). The House version of Section 1129, H.R. 8200, was debtor oriented and did not provide for any true substantive change in the law. 5 *Collier on Bankruptcy* § 1111.02 (15th ed. 1991). The Senate, on the other hand, proposed Section 1129(d) (later numbered 1131) to impose severe restrictions on the treatment of real estate liens and to afford greater protection for secured creditors. *Id.; See also In re Triple R Holding L.P.*, 134 Bankr. 382, 387-8 (Bankr. N.D.Cal. 1991). The effect of the Senate proposal would have been to give the secured creditor veto power over the reorganization process. 5 *Collier on Bankruptcy* § 1111.02, 1111-14 (15th ed. 1991).

There was a compromise reached between the House and Senate designed to balance the debtor's need for protection and access to reorganization against the creditor's right to equitable treatment. New Section 1129(b) in conjunction with Section 1111(b) was enacted to protect an under secured lender from the pre-Code "write down" and give a debtor a means to "cram down" a plan over the lender's objection. The Code contemplates that an under secured lender has a choice in the manner in which its claims are paid. First, the lender may bifurcate its claim per Section 506(a) into a secured claim for the value of the debtor's interest in the property and

an unsecured deficiency claim for the remainder. Alternatively, the lender may elect to have its claim treated secured to the full extent of the claim rather than to the extent of the value of the collateral, and thus be protected in the event the property does appreciate in value and is later sold by the debtor. 11 U.S.C. § 1111(b).

The debtor is, however, entitled to utilize the "cram down" provisions to obtain confirmation upon compliance with all other Section 1129 requirements in the event the lender continues to object to reorganization despite the provisions of Section 1111(b). As stated in *Collier*:

> On the one hand, section 1111(b), taken in conjunction with sections 1124 [definition of impairment] and 1129 [plan confirmation standards], gives the debtor the power to retain encumbered property essential to the debtor's reorganization and to obtain confirmation of its plan in the face of opposition by a class of creditors whose claims are secured by such property. This preserves the debtor's ability to reorganize. On the other hand, sections 1111(b), 1124 and 1129 permit the secured lender to protect itself so as to insure reasonable treatment under a plan. Thus, section 1111(b) protects the legitimate expectation of the secured lender that the bankruptcy laws will be used only as a shield to protect debtors and not as a sword to enrich debtors at the expense of secured creditors.

5 *Collier on Bankruptcy*, § 1111.02, 1111-14-15 (15th ed. 1991). *Accord*, Klee, *Everything You Always Wanted to Know About Cram Down Under the Code*, 53 Am.Bankr. L.J. 133, 161 (1979).

C. *The Spreading Effect of the Restrictive View on Other Sections of the Bankruptcy Code*:

The statutory scheme enacted by Congress and the legislative history support the proposition that reorganization should be a negotiated, preferably consensual process with each side having some measure of power in

the procedure to give true negotiating clout to each. The different constituent groups in reorganization, creditors, debtors and those dependent on the debtor such as employees, suppliers and local governments, all have interests which must be considered. *In re Bjolmes Realty Trust*, 134 Bankr. 1000 (Bankr. Mass. 1991). The creditor control principles embraced by the Fourth and Fifth Circuits place too much emphasis on the rights of creditors without regard to the others involved and in fact grant under secured non-recourse creditors a veto power that was rejected by Congress.

An additional difficulty with the creditor control concept is the disregard that these courts have for express Code provisions in order to obtain their desired results. In a brief footnote, the Fourth Circuit managed to strip governmental authorities with allowed unsecured claims from any meaningful participation in the reorganization process by ignoring Sections 1123(a) and 1124. *Travelers Insurance Co. v. Bryson Properties, XVIII*, 961 F.2d 496, 501 n.8 (4th Cir. 1992), Ap. 8a. The court of appeals recognized that 11 U.S.C. § 1129(a)(10) requires the affirmative acceptance of an impaired class of claims for confirmation. Class 3 containing the impaired claims of governmental taxing authorities voted to accept the plan but the court of appeals reasoned that since these claims received preferential treatment under the Code, the claimants "are not an impaired class that can accept a plan and bind other truly impaired creditors to a cram down". *Id.* The plain facts show that the Code contains an express definition of impairment in Section 1124, that the governmental authorities' claims are clearly impaired by that statutory definition, that there is no distinction in the Code for impaired versus "truly" impaired, and there is certainly nothing in the Code or elsewhere to exclude the class of governmental tax authorities from having a vote that counts.

These same provisions have been ignored by at least two other courts, both of which were relied upon by the

Fourth Circuit as authority for its position. *See In re Winters*, 99 Bankr. 658 (Bankr. W.D.Pa. 1989); *In re Perdido Motel Group, Inc.*, 101 Bankr. 289, 294 (Bankr. N.D.Ala. 1989) (Court notes the "irresistible desire" to ignore Section 1124 of Title 11 but avoids the temptation by deciding that tax claims are not truly a "class"). Similarly, the court of appeals for the Fifth Circuit disregarded the accepting vote of the class of tenant security deposit claimants. *Phoenix Mutual Life Insurance Co. v. Greystone III Joint Venture*, 948 F.2d 134 (5th Cir. 1991) *withdrawn in part on rehearing* (1992). In addition, the First, Fourth and Fifth Circuits disregarded the flexible classification standards in 11 U.S.C. § 1122 (a) and imposed restrictive requirements for classifying unsecured claims that simply do not exist in the Code. *See* Reason No. 2, *infra*.

In summary, there is conflict among the circuits and even within circuits, accompanied in some instances by disregard for express statutory provisions as well as the intent and purpose of the Bankruptcy Code. Serious, important and unresolved questions of federal bankruptcy law are apparent in the conflict on the companion issues of classification and the new value exception presented in this case. Plenary consideration of these issues by this Court is necessary to resolve the conflict and provide uniformity in bankruptcy administration.

II. REVIEW BY THE SUPREME COURT IS NECESSARY TO PROVIDE UNIFORM STANDARDS FOR CLASSIFICATION OF CLAIMS AND TO RESOLVE CONFLICT AMONG THE CIRCUITS.

In order for a plan of reorganization to be confirmed, Section 1129(a)(10) requires that at least one impaired class accept the plan. After refusing to acknowledge the accepting vote of the impaired class of governmental claims, the Fourth Circuit found Bryson's classification of unsecured claimants into three classes impermissible manipulation to obtain the required accepting vote, de-

spite the fact that the court left undisturbed the finding that the Plan was proposed in good faith. *Travelers Ins. Co. v. Bryson Properties XVIII*, 961 F.2d 496 (4th Cir. 1992), Ap. 1a.

A. *Classification and Treatment of Claims in the Plan*:

In the Plan confirmed by the bankruptcy court and affirmed by the district court, Class 5 consisted of the unsecured claim of Continental Bank, Class 6 contained the claims of trade creditors, and Class 7 contained the Section 506(a) unsecured deficiency claim of Travelers. Each of the classes are paid three and one-half percent of the claims on the effective date of the Plan. The debt to Continental Bank was, however, personally guaranteed by one Bryson partner, and general partnership law imposes liability on the partners for the trade creditor debt. Travelers does not have recourse against any person or entity outside of the bankruptcy proceeding. While the debtor classified these claims differently, all the claims were treated in the same fashion by the debtor, each receiving a pro-rata dividend of the same percentage from the debtor's assets, so there was no unfair discrimination as to any class.

Despite the legal dissimilarities of the claims in these three classes and the practical considerations justifying separate classification, the Fourth Circuit significantly restricted the manner in which unsecured claims can be classified by a debtor. By requiring that the unsecured claim of Travelers be classified with the other unsecured claims, the court of appeals has denied the other unsecured creditors any meaningful participation in the reorganization by nullifying their accepting votes and giving the largest creditor, Travelers, effective veto power over the debtor's plan of reorganization.

B. *Permissible Methods and Standards for Classification*:

Section 1122(a) provides that "a plan *may* place a claim or an interest in a particular class only if such claim or interest is substantially similar to other claims or interests of such class". 11 U.S.C. § 1122(a) (emphasis added). While the Code permits substantially similar claims to be classified together, there is no mandate that such claims be classified together. There is no statutory definition of "substantially similar" and the legislative history merely states that "[t]his section codified current case law surrounding the classification of claims and equity securities". H.R.Rep. No. 95-595, 95th Cong., 1st Sess. 406 (1977); S.Rep. No. 95-989, 95th Cong., 2d Sess. 118 (1978). As at least one commentator has recognized, there was no single classification standard in the pre-Code case law thus rendering uncertain the meaning of the legislative history. Blair, *Classification of Unsecured Claims in Chapter 11 Reorganization*, 58 Am. Bankr. L.J. 197 (1984). In fact, "Congress has incorporated, for purposes of interpreting Section 1122, the case law from two provisions with different language, that were adopted for different purposes, and that have been interpreted to mean different things". *Teamsters National Freight Industry Negotiating Comm. v. U.S. Truck Co., Inc.* 800 F.2d 581, 586 (6th Cir. 1986). *See also* Vihon, *Classification of Unsecured Claims: Squaring a Circle?*, 55 Am. Bankr. L.J. 143 (1981) (author questions whether pre-Code case law really applies to the new Chapter 11 because of the consolidation therein of a number of different chapters and standards).

In *U.S. Truck*, the Sixth Circuit recognized the "mixed signals" sent from Congress on Section 1122 interpretation, but found the common theme in pre-Code law to give broad discretion to the lower courts to determine proper classification according to the facts and circumstances of each case thus adopting the flexible approach to classification. Interestingly, the debtor in *U.S. Truck* admitted that its purpose for separate classification of

the unsecured claims was to obtain an accepting impaired class, but the court recognized that there were differences between the claims that justified the separation. *Id.* at 586.

The flexible approach enunciated by *U.S. Truck* has also been followed by the courts of appeal for the District of Columbia and Third Circuits. *Barnes v. Whelan*, 689 F.2d 193 (D.C.Cir. 1982) (section 1122(a) does not prohibit a debtor from grouping unsecured creditors according to whether or not a co-debtor is present in a Chapter 13 case); *In Matter of Jersey City Medical Center*, 817 F.2d 1055 (3d Cir. 1987) (section 1122 prohibits dissimilar claims from common classification but does not require similar claims to be in the same class). Lower courts have also recognized both the legal differences between under secured deficiency claims and other forms of unsecured debt along with practical reasons for adoption of the flexible standard noting that "[s]ome differences in the treatment of unsecured claims must have been contemplated by Congress, or the provisions for classifying claims under 11 U.S.C. Section 1122 would be superfluous and purposeless". *In re AG Consultants Grain Div., Inc.*, 77 Bankr. 665, 671 (Bankr. N.D.Ind. 1987). *See also In re Aztec Co.*, 107 Bankr. 585 (Bankr. M.D.Tenn. 1989) (separate classification of unsecured claims of trade creditors from under secured deficiency claim is permissible because of legal differences between those claims); *Phoenix Mutual Ins. Co. v. Greystone III Joint Venture*, 102 Bankr. 560, 570 (Bankr. W.D.Tx. 1989) *rev'd* 948 F.2d 134 (5th Cir. 1991) *withdrawn in part on rehearing* (1992) (permissible to separately classify trade debt from deficiency claim because of legal differences and practical need to maintain relationship with trade creditors for future operations); *In re Bjolmes Realty Trust*, 134 Bankr. 1000 (Bankr. Mass. 1991) (practical differences between deficiency claim and trade claims warrant separate classification since holders of trade debt would receive nothing from foreclosure of real

property and little if nothing from liquidation of other assets).

The conflicting approach to classification adopted by the Fourth Circuit in the present case is also followed in the First and Fifth Circuits. In *Granada Wines, Inc. v. New England Teamsters and Trucking Industry Pension Fund*, 748 F.2d 42, 46 (1st Cir. 1984), the court of appeals adopted the rule that "all creditors of equal rank with claims against the same property should be placed in the same class". *Accord In re Cantonwood Associates L.P.*, 138 Bankr. 648 (Bankr. Mass. 1992) (Travelers is under secured creditor in single asset real estate case where court follows Fifth Circuit analysis from *Greystone*) *But see In re Bjolmes Realty Trust, supra*, noting the law in its circuit per *Granada Wines*, but finding trade creditors and deficiency claims are not of 'equal rank'. In *Phoenix Mutual Life Ins. Co. v. Greystone III Joint Venture*, 948 F.2d 134, 139 (5th Cir. 1991) *withdrawn in part on rehearing* (1992), the court of appeals refused to permit separate classification announcing that "thou shalt not classify claims differently in order to gerrymander an affirmative vote on a reorganization plan".

As one bankruptcy court has recognized, the cases which hold that unsecured claims must be classified together are attempting to create a statutory requirement where none exists under the Code. *In re AG Consultants Grain Div., Inc.*, 77 Bankr. 665, 675 (Bankr. N.D. Ind. 1987). That court stated:

> The importance of the power to classify claims and interests can hardly be overemphasized. Placement in a particular class may mean the difference between payment and non-payment; early or deferred participation in dividends; participation or non-participation in a debtor's reorganization; acceptance or rejection of a plan, etc.
>
> Chapter 11 is essentially, or should be, a negotiated process; a system to induce compromise. Classifica-

> tion is rooted not merely in statute, but is predicated on the basic need for a reasonable and fair method of maximizing reorganization prospects . . . and yet achieve a ratable distribution among creditors of a debtor's assets.

Id. at 671.

C. *The Danger of the Classification Standard Adopted by the Fourth Circuit*:

In rejecting the debtor's classification of claims in the present case, the Fourth Circuit appears troubled that the other unsecured creditors, smaller in the aggregate than Travelers' unsecured deficiency claim, could vote for the plan and bind Travelers under the cram down provisions. Apparently, the court felt that the debtor's creation of separate classes allowed for minority rule, in terms of dollar amount, thereby avoiding the requirement that an accepting class must vote in favor of the plan by more than a majority in number and at least two-thirds in amount. 11 U.S.C. § 1126(d).

However, this Court should also consider the result which would obtain if this standard is applied under a differing set of facts. Had the trade debt and bank debt totalled in the aggregate at least two-thirds of the total unsecured debt, and had these creditors still voted for the plan, Travelers would have been bound by the terms of the plan as a member of an accepting class. Travelers would then no doubt complain that the other creditors had no reason to vote against the plan, or even to carefully consider the plan provisions, as they would recover the balance of their claims from third parties outside the plan. Under the Fourth Circuit standard imposed in this case, the lumping of dissimilar recourse and non-recourse claims into one class of unsecured creditors would render Travelers mute and without a meaningful vote.

As a member of an accepting class, Travelers would no longer have the protection of Section 1129(a)(7)(ii),

which it now enjoys, requiring as a condition of confirmation that the bankruptcy court find that any non-accepting impaired class would receive at least as much under the plan as it would receive in a Chapter 7 liquidation. In addition, the protections of Section 1129(b) would no longer be available to safeguard Travelers' interest. Only if there is a dissenting class of creditors does Section 1129(b) become operative, and then only with respect to classes which are impaired under, and have not accepted, the plan. If Travelers is treated as a separate class, impaired and not accepting the plan, the bankruptcy court must as a condition of "cram down" find with respect to its unsecured claim that (i) the plan provides that the holder of the claim will receive the present value of the allowed claim, or (ii) no junior claims or interests will receive any property (the absolute priority rule so vigorously defended by Travelers). 11 U.S.C. § 1129 (b)(2)(B). The bankruptcy court must also find that the plan does not discriminate unfairly with respect to such class. These key provisions are designed to protect the unwilling or uncooperative creditor from unfair treatment at the hands of other creditors, who may have less to lose and whose support for the debtor's plan should be viewed differently by the court.

By requiring that all unsecured claims be classified together, the First, Fourth and Fifth Circuits have significantly undermined the negotiation process of Chapter 11 reorganization and placed control in the hands of the large under secured creditor. When all unsecured claims are classified together, the unsecured deficiency claim of the large creditor so dominates the class that its vote prevails in derogation of the rights of the other creditors. 11 U.S.C. § 1126(c). At the same time, the implicit imposition of one broad class for unsecured claims may inadvertently strip some creditors of existing protections from the self-interests of others, when the creditors are not on an equal footing but have equal votes. The debtor is also deprived of classification as an important tool in

the bargaining process, which is so much a part of reorganization. Finally, the controversies involving classification issues are likely to be even more prevalent as efforts are made to avoid the inhibiting aspects of the restrictive approach and uncertainty abounds, necessitating a definitive decision on the issue by the Court.

III. SUPREME COURT DECISION ON THE CONTINUING VITALITY OF THE "NEW CAPITAL EXCEPTION" TO THE ABSOLUTE PRIORITY RULE IS NECESSARY TO RESOLVE THE ISSUE LEFT UNANSWERED IN *AHLERS* AND TO RESOLVE THE CONFLICT SO PREVALENT IN THE LOWER COURTS SINCE ENACTMENT OF THE BANKRUPTCY CODE.

As this Court recognized in *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 203 n.3 (1988), the issue of the continuing vitality of the "new capital exception" to the absolute priority rule has divided the lower courts since enactment of the Bankruptcy Code in 1978. *Ahlers* did not decide the issue as the contribution proposed in that case of future labor, management or expertise has never been sufficient to come within the exception even by pre-Code standards. Despite the admonishment by this Court in footnote 3 that the decision in *Ahlers* "should not be taken as any comment on the continuing vitality" of the new value exception, this is precisely what has occurred. *Id.* The ensuing debate on the meaning of *Ahlers* and the continued conflict of opinion by courts and commenators has been referred to as "proof positive of the power emanating from even a blink of the Court." *In re Bjolmes Realty Trust*, 134 Bankr. 1000, 1006 (Bankr. Mass. 1991). A definitive decision from the Court on this unanswered question is essential to resolve the conflict which sharply divides the circuits and lower courts.

A. *The New Capital Exception, Generally and in the Present Case*:

The absolute priority rule provides in essence that a dissenting class of unsecured creditors must be paid in full before any junior class, usually current equity holders, can receive or retain property in reorganization. *Ahlers, supra.* An exception to the rule commonly referred to as "the new value" or "fresh capital" exception was first enunciated by this Court in *Case v. Los Angeles Lumber Co.*, 308 U.S. 106, 121-2 (1939):

> It is, of course, clear that there are circumstances under which stockholders may participate in a plan of reorganization of an insolvent debtor . . . Where that necessity [of seeking new money 'essential to the success of the undertaking from the old stockholders] exists and the old stockholders make a fresh contribution and receive in return a participation reasonably equivalent to their contribution, no objection can be made . . .
>
> [W]e believe that to accord 'the creditor his full right of priority against the corporate assets' where the debtor is insolvent, the stockholder's participation must be based on a contribution in money or money's worth, reasonably equivalent in view of all the circumstances to the participation of the stockholder.

The exception recognizes that, despite the absolute priority rule, there may be situations in which the only viable source of new money essential to reorganization will be the existing equity holders who should receive some continued participation in the reorganized entity in exchange for the contribution. In order to apply the exception, there must be real necessity for the contribution, the contribution must be substantial, and the equity holder participation in the reorganized entity must be reasonably equivalent to the contribution. *See e.g.* Peeples, *Staying In: Chapter 11, Close Corporations and The Absolute Priority Rule*, 63 Am.Bankr.L.J. 65 (1989) for a detailed

discussion of the requirements for application of the exception.

The Fourth Circuit correctly noted that *Los Angeles Lumber* was decided prior to the enactment of the Bankruptcy Code in 1978 which includes the following:

> [T]he holder of any claim or interest that is junior to the claims of such class [objecting class of unsecured claims] will not receive or retain under the plan on account of such junior claim or interest any property.

11 U.S.C. § 1129(b)(2)(B)(ii). *Travelers Insurance Co. v. Bryson Properties XVIII*, 961 F.2d 496, 503 (1992), Ap. 12a. After noting the division of opinion and conflicting policy considerations surrounding the continued viability of the exception, the court of appeals decided that "the plain words of the statute provide an answer under the particular facts of this case." F.2d at 504 Ap. 14a. Despite the fact that Bryson's partners propose to contribute $1.4 million dollars in cash and a line of credit in exchange for interests in the reorganized entity, the court of appeals reasoned that Bryson's partners receive or retain "property" on account of their prior ownership interests as the debtor has the initial exclusive right to propose a plan under the statute, the partners have given themselves the exclusive right to contribute the capital, and the partners have given themselves a right to return of that capital. F.2d at 504, Ap. 15a.

The court of appeals, however, failed to note that by statute a debtor always has the initial exclusive right to propose a plan. 11 U.S.C. § 1121(b). Further, the court failed to consider that, in order for the exception to apply, the contribution from the equity holders must be necessary and substantial, and these conditions could not be met if there were other readily available sources of capital.[5] Finally, the plan at issue does *not* propose re-

[5] Travelers argued that it was not fair and equitable for the partners to be the only parties afforded an opportunity to make

turn of capital contribution prior to payment of Travelers' unsecured claim. The unsecured deficiency claim is paid three and one-half percent of its amount on the effective date of the plan in full satisfaction thereof, but Travelers could possibly receive an additional dividend in the event the property was sold. *See* footnote 2, *supra*, for example of payment to Travelers in event of sale. At the district court, Judge Bullock correctly noted:

> [C]ontributors of additional money to an already bankrupt company who gain a right to payment in return for their new investments are not in any way cutting in front of superior creditors in the pay-back line. Rather, the new investors share the risk of further loss and, in return, receive benefits. Surely new investment into a struggling enterprise will not come if the investors cannot receive some interest in exchange for their investments. The rule advocated by the Appellant (Travelers) would foil the efforts of struggling businesses to gain new resources from those most willing to risk money on a once-failed venture—the people already associated and familiar with the business.

Travelers Insurance Co. v. Bryson Properties, XVIII, 129 Bankr. 440, 447 (M.D.N.C.) *rev'd* 961 F.2d 496 (4th Cir. 1992), Ap. 29a-30a.

Alternatively, Travelers could have made the Section 1111(b) election which permits Travelers to elect to have its claim secured by the property to the full extent of its claim ($11,234,306.00) rather than to the extent of the value of the collateral ($7,905,068.00). By this election, Travelers would receive a stream of payments based

---

contributions. The evidence, however, clearly shows that there was no other person or entity with any desire to make a contribution or loan to the enterprise. In fact, throughout the bankruptcy proceedings and the appellate process, Travelers has steadfastly maintained its desire to simply foreclose the property pursuant to state law and has argued strenuously that it should not be required to make a further "loan" to this debtor.

on the entire principal amount of its claim with a present value equal to the value of the collateral as well as be protected in the event the property does appreciate and is later sold. In fact, the Plan in this case provides Travelers with the benefits of both alternatives since the Plan proposed to pay Travelers three and one-half percent of its unsecured claim, to pay in excess of $16 million dollars in principal and interest to Travelers for its secured claim over the life of the Plan, and, in the event of a sale, to pay Travelers an additional dividend plus a share (33.3%) of any profits. *See* example in footnote 2, *supra.*

In sum, the "particular facts of this case" show partners of a debtor willing to make substantial monetary contributions without which reorganization will not be possible, and a creditor, Travelers, that has insisted throughout the proceedings on its contractual bargain and the attendant right to foreclose, without regard to the effect thereof on others. This is precisely the kind of case in which the new value exception to the absolute priority rule should be available, yet the court of appeals has given Travelers veto power over the reorganization process and denied debtors the opportunity to cram down a plan utilizing the new value exception.

B. *The New Capital Exception, Applied in Other Circuits; Policy Reasons*:

A majority of courts have continued to consider the new value exception a viable means for a debtor to employ in attempt to obtain confirmation of a reorganization plan since enactment of the Bankruptcy Code. The Eighth Circuit has, on several occasions, recognized the exception. *See In re Blankemeyer*, 861 F.2d 192 (8th Cir. 1988); *Anderson v. Farm Credit Bank of St. Paul*, 913 F.2d 530 (8th Cr. 1990). Similarly, even prior to *Ahlers*, the Sixth Circuit followed the longstanding bankruptcy principle of new value in *Teamsters National Freight Industry Negotiating Comm. v. U.S. Truck Co., Inc.*, 800 F.2d 581 (6th Cir. 1986).

A number of reasons are advanced by the lower courts which have decided that the exception continues to exist. Many courts have considered the fact that neither the plain language of the statute nor the legislative history makes any indication of Congressional intent to change the prior law of which the exception was a large part. *See In re Tallahassee Associates, L.P.*, 132 Bankr. 712 (Bankr. W.D. Pa. 1991); *Penn Mutual Life Ins. Co. v. Woodscape L.P.*, 134 Bankr. 165 (Bankr. Md 1991); *In re Triple R Holdings L.P.*, 134 Bankr. 382 (Bankr. N.D. Cal. 1991). These courts have relied in part on the presumption that Congress did not intend to change the prior law on this issue.

In addition, courts have considered that the absolute priority rule is part of the fair and equitable requirement with respect to the dissenting class. 11 U.S.C. § 1129(b)(2). The language of the statute, however, states that the fair and equitable requirement *includes* the rule, but the statute does not limit consideration solely to those matters in the statute and thus the new value exception is still very much a part of the fair and equitable standard. *See* 11 U.S.C. § 102(3) (the words 'includes' and 'including' are not limiting . ; *In re Bjolmes Realty Trust*, 134 Bankr. 1000, 1008 (Bankr. Mass. 1991).

Also, courts have considered a number of policy reasons which militate in favor of the exception. Included in these reasons is the need to maintain balance at the negotiating table by permitting equity holders to have participation in a reorganized debtor in exchange for the fresh capital needed for reorganization rather than permitting the large under secured creditor complete control, usually thwarting reorganization in the process. *See In re Triple R Holdings L.P., supra*; *see also* Nimmer, *Negoitated Bankruptcy Reorganization Plans: Absolute Priority and New Value Contribution*, 36 Emory L.J. 1009, 1052 (1987). There is also recognition of the fact that the exception was created by this Court to respond to the inflexible approach of the absolute priority rule which, in many cases, subverted the reorganization which

the rule was designed to promote. *See In re Tallahassee Associates L.P., supra.* The same equitable considerations that motivated this Court to initially recognize the exception so many years ago still exist today.

There has, of course, been authority and opinion to the contrary in a number of lower courts. *In re Winters*, 99 Bankr. 658 (Bankr. W.D.Pa. 1989) was one of the first cases to expressly hold that there is no new value exception under the Bankruptcy Code. The court noted the doubt cast on the matter by this Court in *Ahlers* and determined that such an exception would be "in derogation of the express language of the Code". *Id.* at 663. *But see In re Tallahassee Associates L.P.*, 132 Bankr. 712, 717 (Bankr. W.D.Pa. 1991), a decision by another bankruptcy court in the same district of the same state disagreeing with *Winters* and holding that the exception does exist as the "better-reasoned position".

Similarly, the bankruptcy court in *In re Outlook/Century Ltd.*, 127 Bankr. 650 (Bankr. N.D.Cal. 1991) found the plain language of the statutory absolute priority rule to bar any exception. That court, however, emphasized creditor control as a paramount consideration by holding that the unsecured creditors are literally the 'owners' of estate property with the right to determine how their assets will be used to satisfy their claims and finding that "[t]he new value exception is inconsistent with the principle of creditor control". *Id.* at 657-8. There is, however, express authority to the contrary in the same district of California. *See In re Triple R. Holdings, L.P.*, 134 Bankr. 382, 391 (Bankr. N.D.Cal. 1991) (permitting under secured creditors control of the process as advocated by the *Outlook/Century* court would exclude single asset real estate cases from Chapter 11 and such exclusion is not consistent with the notion that Chapter 11 is a single reorganization chapter with flexibility to deal with all kinds of debtors).

Also representative of the uncertainty within circuits on the question are cases in the Seventh Circuit. That court of appeals initially recognized and applied the ex-

ception in *In re Potter Material Service, Inc.*, 781 F.2d 99 (7th Cir. 1986). Subsequent to *Ahlers*, the court of appeals decided that the issue was still open in that circuit despite *Potter*, since that prior decision had assumed without expressly deciding that the exception survived enactment of the Code and thus was not precedent. *In re Stegall*, 865 F.2d 140 (7th Cir. 1989). Following *Stegall*, an Illinois bankruptcy court found the exception to have survived the transition from the Act to the Code until expressly eliminated by a higher court. *In re Snyder*, 99 Bankr. 885 (Bankr. N.D. Ill. 1989). Finally, in *Kham & Nate's Shoes No. 2, Inc.*, 908 F.2d 1351 (7th Cir. 1990), the Seventh Circuit went to great lengths to express its view that the exception did not survive enactment of the Code based on the plain language and legislative history and noted that "so far as the Supreme Court is concerned, however, the development [of the exception] has been 100% dicta". F.2d at 1360. The court, however, declined to expressly decide the question in the same manner as this Court declined to do so in *Ahlers*.

Similarly, in *Phoenix Mutual Life Ins. Co. v. Greystone III Joint Venture*, 948 F.2d 134 (5th Cir. 1991) *withdrawn in part on rehearing* (1992), the Fifth Circuit initially decided that there is no room for the exception in the statutory provision for the absolute priority rule absent consent of the creditors noting that "[t]his flies in the face of the creditor control principle embodied in Chapter 11 and accepted by *Ahlers*." F.2d at 144. On rehearing, the court withdrew the part of its opinion dealing with new value and vacated the bankruptcy court opinion on the question stating "we express no view whatever on that part of the bankruptcy court's decision." Judge Edith H. Jones, author of the original opinion, dissented and voted to reaffirm her prior opinion on the subject.

In addition to the stark differences of opinion among the courts, the issue has been the subject of debate and diversity among commentators. Kenneth N. Klee, formerly associate counsel to the House Judiciary Commit-

tee and a draftsman of the new Code, recognized that the exception was cast into doubt by *Ahlers*, with the lower courts equivocating on the issue thereafter resulting in unrest and uncertainty in the case law. Klee, *Cram Down II*, 64 Am. Bankr.L.J. 229 (1990). According to Mr. Klee, the issue should not be survival of the exception. but its correct application. *Accord* Peeples, *Staying In: Chapter 11, Close Corporations and The Absolute Priority Rule*, 63 Am. Bankr.L.J. 65 (1989) (suggests revamping the exception using the "best interests" standard in Chapter 12 to make the exception more workable for close corporations, partnerships and sole proprietorships); Epling, *The New Value Exception: Is There a Practical, Workable Solution?*, 2 Bankr. Dev.J. 335 (1991). Another commentator notes that the confusion in the lower courts after *Ahlers* is deplorable since the principles involved in the absolute priority rule and the new value exception are so fundamental to reorganizaiton. Markell, *Owners, Auctions and Absolute Priority in Bankruptcy Reorganization*, 44 Stan.L.Rev. 69 (1991) (footnote 3 in *Ahlers* has caused a furor among lower courts with some courts referring to the footnote as a 'divine hint' while others have wallowed in unconvincing attempts to apply or refine the rule). *See also* Scott, *Sharing the Risks of Bankruptcy: Timbers, Ahlers and Beyond*, 1 Colum.Bus. L.Rev. 183 (1989) (recent Supreme Court decisions in *Timbers* and *Ahlers* only serve to reinforce the uncertainties that mar bankruptcy procedure and the conflicting goals of equality of treatment of creditors and rehabilitation of overburdened debtors). There are, of course, commentators who advocate abolishment of the exception. *See e.g.* Baird & Jackson, *Bargaining After the Fall and the Contours of the Absolute Priority Rule*, 55 Univ.Chi.L.Rev. 738 (1988) (authors also believe that two party disputes have no place in bankruptcy); Skeel, *The Uncertain State of an Unstated Rule: Bankruptcy's Contribution Rule Doctrine After Ahlers*, 63 Am. Bankr. L.J. 221 (1989) (but noting that the uncertainty is symptomatic and reflective of the tension permeating all of

bankruptcy and the two goals of protection of creditor rights and promotion of successful reorganization).

The unfortunate result of footnote 3 in *Ahlers* has been diversity of opinion and lack of uniformity even within given circuits on whether the new value or fresh capital exception which is so much a part of bankruptcy law is still viable since enactment of the Bankruptcy Code. This is an issue which must be addressed by this Court to provide the clarification and guidance necessary to the uniform administration of Chapter 11 proceedings.

CONCLUSION

This case presents several important interrelated issues in the context of Chapter 11 cram down reorganization and thus provides a vehicle for definitive resolution of these matters by this Court. This same combination of issues appears in a number of reported decisions with resulting conflicts among the circuits and lack of uniformity in application of the Bankruptcy Code from one circuit and/or district to the next. The efficient operation of the bankruptcy courts is dependent on certainty, uniformity and attendant flexibility in the administration of cases, all of which is compromised by the decision of the court of appeals for the Fourth Circuit. Plenary consideration of these special and important questions is requested.

Respectfully submitted,

JOHN A. NORTHEN
Counsel of Record
JO ANN RAGAZZO WOODS
Post Office Box 2208
Chapel Hill, NC 27515-2208
(919) 968-4441

WILLIAM P. MILLER
Post Office Box 1550
High Point, NC 27261
(919) 889-8733
Counsel for Petitioner

APPENDIX

APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 91-2614

In Re: BRYSON PROPERTIES, XVIII,
Debtor.

TRAVELERS INSURANCE COMPANY,
Plaintiff-Appellant,

v.

BRYSON PROPERTIES, XVIII,
Defendant-Appellee.

Appeal from the United States District Court for the Middle District of North Carolina, at Greensboro
Frank W. Bullock, Jr., District Judge
(CA-90-451-2-CV)

Argued: October 28, 1991

Decided: April 20, 1992

Before WIDENER and LUTTIG, Circuit Judges, and RESTANI, Judge, United States Court of International Trade, sitting by designation.

Reversed and remanded by published opinion. Judge Restani wrote the opinion, in which Judge Widener and Judge Luttig joined.

COUNSEL

ARGUED: Thomas B. Henson, Allen Keith Robertson, ROBINSON, BRADSHAW & HINSON, P.A., Charlotte, North Carolina, for Appellant. John A. Northen, NORTHEN, BLUE, LITTLE, ROOKS, THIBAUT & ANDERSON, Chapel Hill, North Carolina, for Appellee. ON BRIEF: Joann Ragazzo Woods, NORTHEN, BLUE, LITTLE, ROOKS, THIBAUT & ANDERSON, Chapel Hill, North Carolina; William P. Miller, ROBERSON, HAWORTH & REESE, High Point, North Carolina, for Appellee.

OPINION

RESTANI, Judge:

Travelers Insurance Company ("Travelers") appeals from the decision of the district court that upheld the bankruptcy court's order confirming a reorganization plan filed by the debtor, Bryson Properties XVIII ("Bryson"). We reverse and remand on the grounds that the reorganization plan is not fair and equitable to Travelers.

The debtor, Bryson, is a limited partnership organized under Illinois law; the principal place of business of its general partner is Durham, North Carolina. Bryson's sole asset is a complex of three commercial buildings in Omaha, Nebraska, known as "Mid-America Plaza."

Bryson purchased Mid-America Plaza on November 14, 1986, subject to a first mortgage in favor of Travelers, and assumed the seller's obligations under a ten-year nonrecourse note in the face amount of $10.8 million. Bryson made payments on the note for approximately three years, then defaulted. On September 27, 1989, Bryson filed a voluntary petition to reorganize under Chapter 11 of the Bankruptcy Code.

Bryson filed for relief under Chapter 11 for several reasons: loss of an anchor tenant; discovery of asbestos in all three of its buildings; a "soft" real estate market

for commercial buildings; and notice from Travelers of its intent to commence foreclosure proceedings. At the time of filing, the amount due on the note was $11,234.306. Travelers' claim against the debtor consists of (1) a secured claim equal to the value of the debtor's interest in Mid America Plaza—$7,905,068; and (2) an unsecured deficiency claim in the amount of $3,329,238.[1]

On June 18, 1990, the debtor filed the Third Amended Plan of Reorganization ("Plan").[2] The Plan divides claims and interests into eight classes:

> (1) administrative expenses; (2) tenant security deposits; (3) secured tax claims; (4) Travelers' secured claim; (5) the unsecured claim of Continental Bank; (6) the unsecured claims of trade creditors; (7) Travelers' unsecured claim; and (8) equity interests of the Debtor's partners.

Appellant's Brief at 5; *see* Joint Appendix ("J.A.") at 123-24. The Plan provides that the debtor's partners will make a cash contribution to the debtor of $625,000 and extend a line of credit of $850,000. In consideration for their contribution, the partners will retain their interest in the partnership. The Plan treats Travelers' secured claim as follows:

> (1) interest only at the rate of 9.25 percent during years one through three; (2) interest only at the rate of 9.5 percent for years four and five; (3) interest only at the rate of 10 percent for years six and seven; (4) interest only at the rate of 10.5 percent for years eight through ten; (5) a final balloon payment of all

---

[1] In bankruptcy cases where the debtor proposes to retain the property, a claim secured by a lien on the property is converted to a recourse obligation; thus, Travelers' claim is not limited to the value of the debtor's interest in Mid-America Plaza. *See* 11 U.S.C. § 1111(b)(1)(A) (1988).

[2] The bankruptcy judge rejected the Second Amended Plan on the grounds that it was not fair and equitable to Travelers.

> remaining principal and interest at the end of ten years.

Appellant's Brief at 10. *See* J.A. at 130-31. Total payments equal $16,010,590. J.A. at 131.

As for Travelers' Class seven unsecured claim, the Plan provides that Travelers will receive 3.5 percent of its claim in full satisfaction of the debt. The Class five and six unsecured claims also receive 3.5 percent of their claims; however, outside of bankruptcy, the general partner remains liable for the balance of the Class six claims under general partnership law, and certain partners have personally guaranteed the Class five claim.

In the event the property is sold or refinanced within ten years, the Plan provides for the proceeds to be paid as follows:

> $7,905,068 to Travelers, as the outstanding amount on the secured claim; payment of the [$850,000] line of credit provided by the partners; payment of the new cash contribution of the partners . . . in the amount of $625,000; payment to Travelers of any difference in the amount of principal balance shown on the amortization schedule (amortizing the original loan amount of 10.8 million at 5.25 percent) and the principal balance of the secured claim of $7,905,068; and Travelers shares in any net profit thereafter in an amount equal to 33.3 percent.

Appellee's Brief at 5; *see* J.A. 128-29. The Bankruptcy court approved the Plan, and the district court affirmed. This appeal followed.

STANDARD OF REVIEW

The district court's decision is reviewed *de novo*. *In re Camino Real Landscape Maintenance Contractors*, 818 F.2d 1503, 1505 (9th Cir. 1987). The bankruptcy court's findings of fact are reviewed under the clearly erroneous

standard (Fed.R.Bankr.P. 8013; *Willemain v. Kivitz*, 764 F.2d 1019, 1022 (4th Cir. 1985)); its conclusions of law are reviewed *de novo*. *Quinn Wholesale, Inc. v. Northern*, 100 Bankr. 271, 273 (M.D.N.C. 1988), *aff'd*, 873 F.2d 77 (4th Cir.), *cert. denied*, 493 U.S. 851 (1989).

DISCUSSION

1. *Secured Claim*

Travelers argues the Plan is not fair and equitable because Travelers does not receive the present value of its secured claim.

Before a reorganization plan is confirmed, it must be accepted by all impaired classes of claims. *See* 11 U.S.C. § 1129(a)(8) (1988). If a class rejects the plan, the court may nevertheless confirm over the objection of impaired classes so long as the plan "does not discriminate unfairly, . . . is fair and equitable" with respect to each impaired class of claims, and the other requirements of confirmation are met. 11 U.S.C. § 1129(b)(1) (1988).[3]

The "fair and equitable" requirement is not satisfied with respect to a secured claim unless the claimholder: (1) retains its lien; and (2) receives "deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property." 11 U.S.C. § 1129(b)(2)(A)(i)(I)-(II) (1988). The first requirement is not at issue in this case. Under the second requirement, total deferred payments must have a "present value" equal to the amount of the allowed secured claim.[4] *In re Century Inv. Fund*

---

[3] 11 U.S.C. § 1129(b)(1) is called the "cram down" provision; as indicated, it allows confirmation of the plan over the objection of dissenting classes.

[4] "Present value" includes the "time value of money," and "compensates the creditor for not receiving its money today by charging an additional sum based on a rate of interest called the 'discount

VII Ltd. Partnership, 96 B.R. 884, 889 (Bankr. E.D. Wis. 1989 (citations omitted). Here, Travelers asserts that total deferred payments under the Plan are less than the present value of the claim.[5] Travelers makes three arguments.

First, Travelers argues that the debtor's expert, Gary Rifkin, admitted that a loan with the terms required by the Second Amended Plan of Reorganization would not be made under current market conditions. Since no market for the loan exists, Travelers argues present value is not protected. This argument is without merit. Rifkin's testimony pertained to loan terms set forth under the Second Amended Plan; this plan was not approved by the Bankruptcy Court.

Second, Travelers argues the Plan's interest rates are below market rates for similar loans. Evidence presented by the debtor in support of the Second Amended Plan is to the contrary. Rifkin testified that a loan on property like Mid-America Plaza would have a term of three to five or seven to ten years, and an interest rate that was fixed or adjusted at certain intervals. He testified that the market rate for ten-year loans made by insurance companies over the three years prior to June 1990 ranged from 9.25 to 11 percent; for the one year period prior to June 1990, rates ranged between 8.5 percent and 10.25

---

rate.'" *In re S.E.T. Income Properties, III*, 83 B.R. 791, 793 (Bankr. N.D. Okla. 1988). The parties agree that Collier's rule applies to determine the discount rate:

> The appropriate discount rate must be determined on the basis of the rate of interest which is reasonable in light of the risks involved. Thus, in determining the discount rate, the Court must consider the prevailing market rate for a loan of a term equal to the payout period, with due consideration to the quality of the security and the risk of subsequent default.

5 *Collier on Bankruptcy*, ¶ 1129.03(4)(f)(i) (15th ed. 1990) at 1129-85.

[5] The Bankruptcy judge's findings on this issue are reviewed under the clearly erroneous standard. *See Camino*, 818 F.2d at 1508.

percent. Rifkin further testified that the market rate of interest for the loan made by Travelers would be between 9.875 and 10.25 percent, and that participation rights might reduce this percentage by between one-eight and one-quarter of a percent.[6] Finally, he testified that the rate on Treasury bills was 8.74 percent, and that rates for ten-year loans would be about one to two percent higher.

Here, the interest rates under the Plan begin at 9.25 percent, then increase at two or three year intervals to 10.5 percent. These figures correspond to Rifkin's testimony concerning the range of interest rates for the previous three-year period. In addition, allowing for an adjustment due to greater participation rights under the Third Amended Plan, these figures are also supported by Rifkin's testimony on the market interest rate for the loan made by Travelers.[7]

Third, Travelers argues that the best evidence of the appropriate discount rate is the contract rate, which was 11.875 percent for five years, then 12.875 percent. Travelers relies on *In re Monnier Bros.*, 755 F.2d 1336 (8th Cir. 1985), a case in which the reorganization plan called for deferred debt payments. In that case, the district court reversed the bankruptcy court's decision insofar as it fixed the interest rate at a rate below the contract rate, and reinstated the contract rate. The Eighth Circuit affirmed, finding that neither party provided the bankruptcy court with sufficient evidence to enable it to determine the present value of the creditor's money. Under

---

[6] In the Second Amended Plan, Travelers' participation in the proceeds of a sale was 20 percent; in the Third Amended Plan, it is increased to 33.33 percent.

[7] Travelers also argues the Plan permits the debtor to defer payment of the prevailing market rate until the last five years of the loan, causing the loan amount to increase or "negatively amortize." Travelers' argument is based on a faulty premise because the initial interest rate of 9.25 percent is within the range of prevailing market rates.

these circumstances, the court held, the contract rate, negotiated only twenty months earlier, reflected present value. *Id.* at 1339. This case is distinguishable from the case at bar in which the debtor introduced evidence of the present value of the debt. This evidence was a more reliable indicator than the contract rate.

In summary, Travelers' arguments concerning present value are unpersuasive, and the district court did not err in affirming the bankruptcy court's finding that the Plan gives Travelers an amount equal to the present value of its claim.

2. *Unsecured Claim*

Travelers makes the following arguments with respect to treatment of its unsecured claim: (a) Bryson manipulated classification of claims for the purpose of obtaining a confirmable plan; and (b) the Plan violates the absolute priority rule.

a. *Manipulation of Voting*

Before a plan can be crammed down, at least one non-insider impaired class of claims must vote to accept it. *See* 11 U.S.C. §§ 1129(a)(10), 1129(b)(1) (1988). Here, although all unsecured claims are purportedly treated alike under the Plan, Bryson separated unsecured claims into three classes. Classes five and six voted to accept, and Class seven, consisting of Travelers' claim, voted to reject. Travelers argues that without separate classification of unsecured claims the Plan could not have bene confirmed.[8]

---

[8] Class three—unpaid ad valorem taxes—also voted to accept. For Travelers to succeed with its argument that the debtor manipulated classes to obtain a confirmable plan, the acceptance of the Class three claims would have to be disregarded. In *In re Perdido Motel Group, Inc.*, 101 B.R. 289 (Bankr. N.D. Ala. 1989), the court noted that priority tax claims are not designated as a "class" within the definition of § 1123(a). *Id.* at 294. The court held that acceptance

11 U.S.C. § 1122 pertains to classification of claims and interests under a reorganization plan. It provides:

> (a) Except as provided in subsection (b) of this section, a plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class.
>
> (b) A plan may designate a separate class of claims consisting only of every unsecured claim that is less than or reduced to an amount that the court approves as reasonable and necessary for administrative convenience.

11 U.S.C. § 1122 (1988). Section 1122 requires substantial similarity between claims that are placed in the same class. It does not, however, require that all substantially similar claims be placed within the same class, and it grants some flexibility in classification of unsecured claims. Nonetheless, as several courts have held, there is a limit on the debtor's power to classify claims:

> Although the proponent of a plan of reorganization has considerable discretion to classify claims and interests according to the facts and circumstances of the case, this discretion is not unlimited. There must be some limit on the debtor's power to classify creditors. . . . The potential for abuse would be significant otherwise. . . . If the plan unfairly creates too many or too few classes, if the classifications are designed to manipulate class voting, or if the classification

---

of a plan by priority tax claimants is not acceptance by a "class" of impaired claims under § 1129(a)(10) for purposes of cram down. *Id.; see also In re Winters*, 99 B.R. 658, 663-64 (Bankr. W.D. Pa. 1989) (whether priority tax creditors are paid according to statute or agree to a different treatment, they are not an impaired class for purposes of cram down). We agree that priority tax claimants, which receive preferential treatment under the Code (*see* 11 U.S.C. § 1129(a)(9)(C)), are not an impaired class that can accept a plan and bind other truly impaired creditors to a cram down.

scheme violates basic priority rights, the plan cannot be confirmed.

In re Holywell Corp., 913 F.2d 873, 880 (11th Cir. 1990) (citations omitted); *see also In re Greystone III Joint Venture*, 948 F.2d 134, 139 (5th Cir. 1992) (as amended) ("thou shalt not classify similar claims differently in order to gerrymander an affirmative vote on a reorganization plan"). Thus, although separate classification of similar claims may not be prohibited, it "may only be undertaken for reasons independent of the debtor's motivation to secure the vote of an impaired, assenting class of claims." *Greystone*, 948 F.2d at 139.

Bryson claims that separate clasisfication of unsecured claims is warranted because Travelers' claim arises from a nonrecourse loan, whereas the Class five and six claims are recourse loans. Travelers counters that under the Bankruptcy Code its nonrecourse claim is converted into a recourse claim (*see* 11 U.S.C. § 1111(b)(1)(A) (1988)), and there is no basis for distinguishing between Code-created deficiency claims and "natrual" recourse claims, where the claimholders have recourse as a matter of state law.

At least one court has held that the distinction between Code-created unsecured deficiency claims and other unsecured claims does not warrant separate classification. *Greystone*, 948 F.2d at 140.[9] Even if we adopt a flexible approach to § 1122, however, the clasisfication scheme at issue is impermissible. Where all unsecured claims receive the same treatment in terms of the Plan distribution, separate classification on the basis of natural and unnatural recourse claims is, at a minimum highly suspect. In this case, Bryson has failed to offer any reason

---

[9] *But see In re Aztec Co.*, 107 B.R. 585, 592 (Bankr. M.D. Tenn. 1989) ("unfair discrimination" determination requires consideration of totality of circumstances; existence of "natural" and "unnatural" recourse claimants is factor to consider but is not outcome determinative).

for separate classification of the unsecured claims which will withstand scrutiny. The classification is clearly for the purpose of manipulating voting and it may not stand.[10]

Although a remand is necessary on the classification issue alone, for the sake of judicial economy, we will address Travelers' argument that the Plan violates the absolute priority rule.

b. *Absolute Priority Rule and New Capital Exception*

Travelers argues that the Plan violates the absolute priority rule because the debtor's partners retain their interest in the partnership even though Travelers' unsecured claim is not paid in full. In addition, Travelers argues that the rule is violated because, in the event the property is sold, the partners will recover their contribution before payment of Travelers' unsecured claim.

The absolute priority rule provides that "a dissenting class of unsecured creditors must be provided for in full before any junior class can receive or retain any property [under a reorganization] plan." *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 202 (1988) (quoting *Norwest Bank Worthington v. Ahlers*, 794 F.2d 388, 401

---

[10] Travelers argues that dissimilar *treatment* of the unsecured claim outside the Plan is improper. This argument has no merit. The unsecured claims receive the same treatment in terms of the Plan distribution, and there is no support for the position that Travelers' unsecured claim should result in personal liability for the partners outside of bankruptcy. As Collier states:

> There has been some concern expressed as to the effect of the conversion of a nonrecourse claim to a recourse claim under § 1111(b)(1). One of the areas of concern is whether the conversion of a nonrecourse claim against partnership property creates a recourse claim against the individual partners who, absent the nonrecourse covenant, would be liable for the partnership debt. It is suggested that in adopting section 1111 (b)(1), Congress did not intend to enlarge a creditor's rights against parties other than the debtor.

5 *Collier on Bankruptcy*, ¶ 1111.02, at 1111-23.

(8th Cir. 1986)); *see also Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106, 116 (1939). The rule was codified in 11 U.S.C. § 1129(b)(2)(B)(ii) of the Bankruptcy Code, enacted in 1978, which provides:

> [T]he holder of any claim or interest that is junior to the claims of . . . [the dissenting class] will not receive or retain under the plan on account of such junior claim or interest any property.

11 U.S.C. § 1129(b)(2)(B)(ii) (1988). The rule stems from the requirement that a plan must be fair and equitable before it can be confirmed over the objection of dissetting creditors. *See* 11 U.S.C. § 1129(b)(2); *Ahlers*, 485 U.S. at 202.

In this case, it is clear that a junior class retains property under the Plan while a senior class of unsecured creditors is not paid in full. Bryson argues, however, and the district court held, that the Plan was confirmable because the absolute priority rule, as codified, includes the previously recognized "new capital exception." The "new capital exception" was set forth by the Supreme Court in *Los Angeles Lumber*. There, the Court found:

> It is, of course, clear that there are circumstances under which stockholders may participate in a plan of reorganization of an insolvent debtor. . . . Where th[e] necessity [for new money] exists and the old stockholders make a fresh contribution and receive in return a participation reasonably equivalent to their contribution, no objection can be made.

308 U.S. at 121.

Los Angeles Lumber was decided before the 1978 Bankruptcy Code was enacted, and the courts are divided as to whether codification of the absolute priority rule in § 1129(b)(2)(B)(ii) tolled a death knell for the exception.[11] The Supreme Court specifically declined to decide

---

[11] There is some debate as to whether it was a true exception or simply another aspect of the judge-made absolute priority rule. One

the issue in *Ahlers*. 485 U.S. at 203 n.3. Since that time, several circuit courts have questioned the continuing viability of the exception or have otherwise passed over the issue, but have not decided it. *Greystone*, 948 F.2d at 142 (vacating bankruptcy court's opinion upholding new value exception but declining to rule on question); *Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting*, 908 F.2d 1351, 1361-63 (7th Cir. 1990) (questioning vitality of exception but finding it inapplicable on facts); *In re U.S. Truck Co.*, 800 F.2d 581, 588 (6th Cir. 1986) (applying exception without discussion). The bankruptcy courts are divided on the issue. *Compare, e.g., In re Woodscape Ltd. Partnership*, 134 B.R. 165, 175 (Bankr. D. Md. 1991) (new capital exception not barred by statute; adequacy of new value contribution determined on facts); *In re 222 Liberty Assocs.*, 108 B.R. 971, 984-85 (Bankr. E.D. Pa. 1990) (exception exists when there is present contribution with showing of necessity for contribution); *In re Snyder*, 99 B.R. 885, 888 (Bankr. C.D. Ill. 1989) (exception viable until eliminated by higher court), *with In re Outlook/Century Ltd.*, 127 B.R. 650, 656 (Bankr. N.D. Cal. 1991) (exception no longer viable based on plain language of statute); *Piedmont Assoc. v. Cigna Property & Casualty Ins. Co.*, 132 B.R. 75, 79 (N.D. Ga. 1991) (statutory language and Congressional intent preclude exception; exception inapplicable on facts); *In re Lumber Exchange Ltd. Partnership*, 125 B.R. 1000, 1008 (Bankr. D. Minn.) (confirmation improper where plan gives debtor's equity security holders a special right to retain or acquire interest through cash contribution; exception not applicable on facts), *aff'd*, 134 B.R. 354 (D. Minn. 1991).

---

author states that "use of the term 'exception' to describe new value principles is a catachresis . . . [because] [t]he conditions required to satisfy the new value 'exception' also satisfy the absolute priority rule." Bruce A. Markell, *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 Stan. L. Rev. 69, 96 (Nov.1991).

There is no clear bankruptcy policy which dictates result. On the one hand, Congress might have intended that some exception continue because an infusion of new capital may be essential to the success of a new venture and the equityholders are a natural source for this capital. *See Kansas City Terminal Ry. Co. v. Central Union Trust Co.*, 271 U.S. 445, 455 (1926). On the other hand, if the reorganization plan represents a reasonable business risk, creditors should be willing to forego immediate recoveries in exchange for the expectation of greater recoveries in the future, in which case they would consent to viable plans providing for new capital infusions.[12] *See Kham & Nate's Shoes*, 908 F.2d at 1360.

Whether or not Congress was making a broad policy choice as to debtor or creditor control, the plain words of the statute provide an answer under the particular facts of this case.[13] The question is whether the equity-

---

[12] One commentator has noted that the Bankruptcy Code represents an accommodation between two competing interests—protection of creditors' rights and the need for successful reorganization. David A. Skeel, *The Uncertain State of An Unstated Rule: Bankruptcy's Contribution Rule Doctrine After Ahlers*, 63 Am. Bankr. L.J. 221, 223 (1989). He states that the absolute priority rule and the new capital excetion may be viewed as surrogate for these two competing goals. *Id.* at 229.

[13] The legislative history sheds little light on the picture; however, we note the statement on the floor by Congressman Edwards concerning § 1129(b)(2)(B)(ii). This statement indicates that the statutory language and its legislative history are not inconsistent: "[T]he plan may be confirmed if the impaired class of unsecured claims receives less than 100 cents on the dollar (or nothing at all) as long as no class junior to the dissenting class receives anything at all." 124 Cong. Rec. 32,408 (1978).

Several courts have found it significant that Congress rejected a proposal by the Bankruptcy Commission which would have codified the new capital exception and permitted participation by equityholders based on contributions of "continued management . . . essential to the business" or other "participation other than in money or money's worth." *Report of the Commission on the Bankruptcy Laws of the United States*, H.R. Doc. No. 137, 93d Cong.,

holders receive anything "on account of" their prior interest. Under the Bankruptcy Code, the debtor has the exclusive right to propose a reorganization plan for 120 days. 11 U.S.C. § 1121(b) (1988). In the proposed Plan, the equityholders have given themselves not only the exclusive right to contribute, but the right to return of their new capital prior to Travelers' recovery of its unsecured claim. As Travelers states in its brief: "the debtor's equity holders were the only parties afforded the right to contribute new capital. In effect, they were allowed to 'buy' the property without exposing it to the market or otherwise allowing any other party, including Travelers, the opportunity to bid." Appellant's Brief, at 29. This exclusive right to contribute constitutes "property" under § 1129(b)(2)(B)(ii), which was received or retained on account of a prior interest. *Lumber Exchange*, 125 B.R. at 1008 (special opportunity for equityholders to retain or acquire interest through new cash contribution is necessarily right to receive or retain property on account of prior interest);[14] *In re Outlook/Century Ltd.*,

---

1st Sess. pt. 2 at pp. 241-42; pt. 1 at p. 258, *reprinted in Collier on Bankruptcy*, vol. 2 app. (15th ed. 1990); *Kham & Nate's Shoes*, 908 F.2d at 1361-62. The proposed modification would have liberalized the absolute priority rule and recognized the types of intangible contributions that were rejected by the Supreme Court in *Los Angeles Lumber*. *See* H.R. Doc. No. 137, pt. 1 at p. 258. Rejection of this proposed modification indicates no more than Congress's decision not to expand the exception (*see Ahlers*, 485 U.S. at 206); it does not indicate rejection of the exception itself. Thus, the legislative history is inconclusive.

[14] In *Lumber Exchange*, the court stated:

> A special opportunity or right afforded to members of a class of equity security holders to retain or acquire an equity position in a reorganized debtor through a new cash contribution under a plan is, by its very nature, the opportunity or right to receive or retain property on account of the prepetition interest held. When the opportunity is fulfilled, or the right exercised, clearly, the interest is retained or received *on account of* the

127 B.R. at 654 (partners' exclusive rights to obtain equity interests in debtor constitutes property that the partners retain "on account of" existing interests); *Piedmont Assocs.*, 132 B.R. at 79 (without ability to structure reorganization plan, partner would be unable to maintain interest by "buying" interest in debtor without public sale).

Finally, while it is not impermissible to propose a plan which only adjusts the interests of one creditor, this situation certainly must cause a court to scrutinize closely the equities involved. Under the Plan or through outside payments, the claims of all creditors, other than Travelers, will be paid in full. Only Travelers is truly impaired. This combination of factors leads us to conclude that even if some limited new capital exception were viable under the Bankruptcy Code, it would not be so expansive as to apply under the facts of this case. A plan must be fair and equitable in a broad sense, as well as in the particular manner specified in 11 U.S.C. § 1129 (b) (2). Here, the debtors have carried their opportunity for self-dealing too far.[15]

CONCLUSION

The district court's decision affirming confirmation of the Plan by the bankruptcy court is reversed, and the case is remanded to the bankruptcy court for further findings consistent with this opinion.

REVERSED AND REMANDED

---

prior interest, even though new consideration is paid in the transaction.

125 B.R. at 1008.

[15] *See The Uncertain State of An Unstated Rule*, 63 Am. Bankr. L.J. at 238 (noting that debtor's exclusive privilege to propose reorganization plan in combination with contribution rule may lead to self-dealing); *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 Stan. L. Rev. at 118-119 (proposing as means to equalize bargaining power that court find filing new value plan sufficient "cause" under statute to terminate debtor's exclusive right to propose plan).

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF NORTH CAROLINA
GREENSBORO DIVISION

B-89-12311-C-11

IN RE BRYSON PROPERTIES XVIII

2:90CV00451

THE TRAVELERS INSURANCE COMPANY,
Plaintiff/Appellant,
v.

BRYSON PROPERTIES XVIII,
Defendant/Appellee.

MEMORANDUM OPINION

[Filed Feb. 8, 1991]

BULLOCK, District Judge

This appeal concerns the propriety of the bankruptcy court's confirmation of the reorganization plan of Debtor Bryson Properties XVIII (hereinafter "Bryson"). Following a decline in the demand for office space and the discovery of asbestos in three Omaha, Nebraska, office buildings owned by the Debtor, the Debtor sought bankruptcy relief to enable it, among other things, to rework its loan obligations to The Travelers Insurance Company (hereinafter "Travelers"). Travelers, which loaned millions to the previous owner of the buildings, and which

now stands to receive millions less back, challenges its treatment under the bankruptcy court approved reorganization plan. When Bryson acquired the buildings, known as "Mid America Plaza," in 1986, it took them subject to Travelers' $10.8 million security interest protecting its loan.

Finding no error in the handling of this case by the bankruptcy court, the court will affirm the decision approving the Debtor's reorganization plan.

BACKGROUND

The Debtor filed for bankruptcy in September of 1989, after properly making payments on the Travelers loan for approximately three years. Bryson alleges that its bankruptcy was caused by the departure of a major tenant from its office buildings, the discovery of a tremendous asbestos pollution problem in all three buildings, and the general decline in real estate values (including rental values) in the economy, among other factors. Travelers is the largest single creditor to file a claim against the Debtor's estate.

After the Debtor submitted plans that were unacceptable because of their failure to treat Travelers fairly, the bankruptcy court confirmed the Debtor's Third Amended Plan of Reorganization (hereinafter the "Third Plan"). It ruled that the Third Plan was consistent with the requirements of 11 U.S.C. § 1129, that the Plan did not discriminate against Travelers, and that it treated Travelers fairly and equitably.[1]

The Third Plan differentiates between Travelers' secured interest in the property ($7,905,068.00), and Travelers' unsecured interest ($3,329,238.03). Both parties

---

[1] Hearing before the Honorable Jerry G. Tart at 26 (June 25, 1990).

agree that these figures represent the correct amounts of the claims.[2]

Under the terms of the Third Plan, Travelers purportedly would receive an amount in the future equivalent to the present value of its secured claim. Travelers disputes the Debtor's claim that the payments it would receive under the Plan have a present value, when discounted for inflation, loss of use, etc., equal to the value of the secured claim. Travelers correctly points out that as a secured creditor it is entitled to receive an amount equal to the value of its secured claim as of the date the Third Plan was approved.

Travelers specifically objects that the Plan's provision for interest payments at an escalating rate, running from 9.25% to 10.5%, and averaging a return of 9.79% per year over the next ten years, is inadequate.[3] At the end of the ten years, Travelers is to be paid all remaining principal owed on its secured claim.

Travelers will receive an additional return on its secured claim if Mid America Plaza is sold within ten years. Should the buildings be sold or refinanced before the end of the pay-back period, Travelers would receive its secured principal, then new capital infused into the enterprise by its reorganizers would be repaid to them, and then Travelers would receive a payment equal to the difference between $7,905,068.00 and the original $10.8 million that it was to receive, amortized at a rate of 5.25% per year. Additionally, Travelers would receive one-third) (1/3) of any profit made above and beyond

---

[2] The Appellant actually states that the amount of the unsecured claim is three cents higher than the Appellee does. Without taking a position on the proper amount of the unsecured claim, the court will assume for the purposes of its discussion that the Appellant's claim is correct. The bankruptcy court can resolve this dispute if it is necessary for a court to do so at some later date.

[3] The parties agree that the average rate would be 9.79%. Brief of Appellant at 13; Brief of Appellee at 12.

the amount needed to make the payments on the secured claim listed above, should the sale of Mid America Plaza yield such profits.

Regarding the unsecured debt owed Travelers, the Debtor proposes to pay only 3.5% as full satisfaction of the debt. Third Amended Plan of Reorganization at 12 (filed June 18, 1990). This proposal draws something more than a mild expression of discontent from Travelers because the other unsecured creditors of the Debtor will recoup more than just this payment of 3.5%; the Third Plan requires the general partner and partner guarantor of the bankrupt partnership to pay *all* of the remaining amounts owed on the other unsecured claims within thirty days of the Third Plan's approval. *Id.*

Not only do the parties disagree on the question of whether the Third Plan unfairly discriminates against Travelers and fails to treat its claim fairly and equitably, but as an initial matter they cannot agree on the standards of review to apply. In particular, the Appellant contends that (1) the Third Plan does not assure it payment of an equivalent to the present value of its secured claim, (2) the Plan unfairly discriminates against Travelers' unsecured claim by paying other unsecured claims in full and only a few cents of each dollar owed it, (3) the Third Plan is not fair and equitable for various reasons, and (4) the entire case should be reviewed *de novo*.

DISCUSSION

A. *The Standard of Review*

The Court must first consider the standard of review. Bankruptcy Rule 8013 provides in part, "Findings of fact, whether based on oral or documentary evidence, shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the bankruptcy court to judge the credibility of the witnesses." Thus, "factual findings should not be disturbed unless clearly erroneous,"

while "legal conclusions are subject to *de novo* review." *Quinn Wholesale, Inc. v. Northern*, 100 Bankr. 271, 273 (M.D.N.C. 1988), *aff'd*, 873 F.2d 77 (4th Cir.), *cert. denied*, 110 S. Ct. 151 (1989).

A significant issue in this case is the bankruptcy court's determination that Travelers will receive an amount equal to the present value of its security in Mid America Plaza under the Third Plan. The bankruptcy court's determination was based upon evidence of how interest rates fluctuate with the length of a loan, Treasury Bill interest rate, the testimony of a witness from the banking industry, and other factors. While the Appellant would have this court review the evidence anew, under a *de novo* standard, at least two circuit courts have gone the other way. They have held that decisions concerning money value made by bankruptcy courts are *not* reviewed *de novo*. In the context of evaluating the value of property contributed to a reorganizing debtor, as well as the value of an interest rendered by the debtor, the Seventh Circuit held that deference was owed decisions of the bankruptcy court. *In re Potter Material Serv., Inc.*, 781 F.2d 99, 103-04 (7th Cir. 1986). The court explained,

> The court based its valuation of Potter upon 'the Debtor's past earnings record, the state of the economy, the highly competitive nature of the Debtor's business, the present financial position of the Debtor and the Debtor's projections of future earnings.' The valuation of a corporate Debtor is a complex task, requiring an evaluation of considerable data concerning the past, present, and future operations of the Debtor. Unless the creditors challenging a "cramdown' reorganization can show that the court made an erroneous evaluation, this court will not reweigh the evidence on appeal.

Id. at 104. Likewise, the Ninth Circuit considered "a single issue" in *In re Camino Real Landscape Maintenance Contractors*, 818 F.2d 1503, 1504 (9th Cir. 1987):

"[W]hat rate of interest on deferred payments . . . will provide the government payments having a present value equal to the amount of its claim." The court explicitly stated that while the issue before it concerned a tax claim, it intended its decision to apply as well to present value questions under 11 U.S.C. § 1129(b)(2)(A). *Id.* n.1. *Camino Real* then held that the bankruptcy court's determination of what future payments would have a present value equal to the present value of the creditor's claim "should be accorded substantial deference." 818 F.2d at 1508.

In the same vein, this court will accord substantial deference to the bankruptcy court's conclusion that Travelers will receive an amount equal to the present value of its secured claim under the Third Plan; that court's evaluation will not be set aside unless shown to be clearly erroneous. On the other hand, as indicated above, questions of law raised by the Appellant will be reviewed *de novo*.

B. *Is the Present Value of Travelers' Secured Claim Protected?*

11 U.S.C. § 1129 sets out certain prerequisites to the approval of a bankruptcy reorganization plan despite the objection of one class of the estate's creditors. Among the fundamental requirements is a rule that the plan must deal with dissenting creditors fairly and equitably. Moreover, a plan cannot be found fair and equitable unless the requirements of 11 U.S.C. § 1129(b)(2) are met. For secured claims, one such requirement is that the plan must ensure "that each holder . . . receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property." 11 U.S.C. § 1129(b)(2)(A)(i)(II). Compliance with this provision may involve payment of one lump sum at some

future date, which when discounted has a present value equal to that of the secured claim, or payment of a series of installments which when discounted are together the equivalent of the secured claim in current dollars. *See Bankruptcy Law Revision: Report of the Committee on the Judiciary*, H. Rep. No. 595, 95th Cong., 1st Sess. 414-15 (1977). Alternatives to future payment of the present value of the secured claim are the current payment of any "indubitable equivalent" to the cash value of the secured claim and the transfer of the creditor's liens to new property exchanged for the property the creditors has a lien against. 11 U.S.C. § 1120(b)(2)(A).

This court must presently decide whether the Third Plan's provisions concerning Travelers' secured claim, including interest at an average rate of 9.79% over a ten-year period, the payment of a lump sum equal to the principal owed at the end of the ten years, and participation in the proceeds of a possible sale of Mid America Plaza, were collectively equal to the value of Travelers' interest in the collateral for its loan ($7,905,068.00) on the date the bankruptcy court confirmed the Plan. The court will, as indicated above, review the bankruptcy court's evaluation under a clearly erroneous standard.

At the May 22, 1990, hearing on the Second Amended Plan proposed by the Debtor, the bankruptcy court received evidence on commercial interest rates for five- and ten-year loans. For ten-year loans made by insurance companies on income property, the evidence showed that the interest rates fluctuated between 9.25% and 11% over the three years prior to the confirmation of the Third Plan (the Plan was confirmed in June of 1990). In the last year before confirmation, the rate fluctuated between 9.25% and 10.5%.

The return paid on ten-year Treasury Bills on the date of the hearing was 8.74%. A witness experienced at arranging financing for income-producing real estate and employed by a mortgage banking company explained that

typical rates for ten-year loans would be about 1.1% to 2% higher than the Treasury Bill rate. Hearing before the Honorable Jerry G. Tart at 41 (May 22, 1990). The witness also said that lenders possibly receiving a percentage of profits from a sale of real estate securing a loan would typically lower the interest rate charged. *Id.* at 45-46.

In light of the evidence received by the bankruptcy court, this court does not believe that the confirmation of a plan providing for payment of an average return of 9.79% was improper. While the court did see evidence that interest rates are often higher where a loan is for the full current value of commercial property (allowing no cushion to a lender should the property depreciate) reorganization is approved only where the debtor is believed likely to succeed at its reorganization efforts. *See* 11 U.S.C. § 1129(a)(11). Thus, the bankruptcy court did determine that the Debtor will in all probability be able to meet its commitments under the Plan and this court will not deem the treatment of Travelers inadequate on that basis. All in all, the bankruptcy court's finding that Travelers will receive an amount equal to the present value of its secured claim under the terms of the Plan seems reasonable.

C. *Discrimination Against the Unsecured Claim*

In addition to requiring that reorganization plans pay dissenting creditors an equivalent to the present value of their claims, Section 1129 requires that they not be unfairly discriminated against under the plans.

As indicated above, the Third Plan does require full payment of the unsecured claims of minor creditors (Continental Bank is owed $602,771.00 and the trade creditors are owed $83,574.85), and only fractional repayment of Travelers' unsecured claim (for over $3 million). Nevertheless, the payment of any portion of the unsecured creditors' claims exceeding 3.5% of those claims will not be

made by the Debtor, but by the partners *who are already liable for that money*. As a matter of partnership law, it is undisputed that the general partner of the Debtor is accountable for certain obligations of the Debtor despite the bankruptcy of the partnership. *See* 9 *Am. Jur.* 2d *Bankruptcy* § 265 (1980). Similarly, despite the partnership's bankruptcy, the guaranteeing partner is liable for the obligation he personally guaranteed would be repaid. While Travelers bemoans the fact that the Plan reassures the other creditors that their claims will be honored by the partners, it should be noted that the Code itself recognizes the enforceability of recourse debt against an insolvent partnership's general partners. 11 U.S.C. § 723. The Third Plan does therefore make some distinction in its treatment of the unsecured creditors, but the Plan is not the source of Travelers' disadvantage. The distinction made by the Third Plan is simply not one prohibited by the Code.

In a much quoted passage, *Collier on Bankruptcy* explains how courts may recognize unfair discrimination. "Reducing 'discrimination' to its bare essentials, a dissident class must not only receive 'fair and equitable' treatment, but the class must also receive treatment which allocates value to the class in a manner consistent with the treatment afforded to other classes with *similar legal claims* against the debtor." 5 *Collier on Bankruptcy* ¶ 1120.03 at 1129-68, -69 (15th ed. 1990) (emphasis added). Where legal claims are sufficiently different as to justify a difference in treatment under a reorganization plan, reasonable differences in treatment are permissible. Many courts have already taken this position, and surely it is consistent with the Code's indication that only *unfair* discrimination will not be tolerated. *See In re Aztec Co.*, 107 Bankr. 585, 589-91 (Bankr. M.D. Tenn. 1989) (providing a long list of distinctions that have been found acceptable in certain reorganization cases under varying circumstances); *In re Johns-Manville Corp.*, 68 Bankr. 618, 636 (Bankr. S.D.N.Y. 1986) ("In

the present case, the interests of the Class 8 common shareholders are not similar or comparable to those of any other class. Thus, this court finds no unfair discrimination."); *cf In re Meadow Glen, Ltd.*, 87 Bankr. 421, 426-27 (Bankr. W.D. Tex. 1988) (unsecured creditors "must be treated equally unless there are valid reasons to do otherwise"); *In re Baugh*, 73 Bankr. 414, 417 (Bankr. E.D. Ark. 1987) (where there was no proper basis for distinguishing between the unsecured claim of a judgment creditor and other unsecured creditors, a plan could not legally discriminate between unsecured creditors). In this case, the claims of the two unsecured creditors treated different *are* dissimilar to Travelers' claim. The minor difference in treatment under the Third Plan —restatement of the legal reality that the general partner and the partner guarantor of the Debtor are not off the hook for the portion of claims left unpaid by the Debtor—is justified.

The court acknowledges that one sentence in 11 U.S.C. § 1111(b)(1)(A) is ambiguous and provides some support for the Appellant's argument that the Third Plan should not discriminate between the unsecured creditors. That statute provides, "A claim secured by a lien on property of the estate shall be allowed or disallowed . . . the same as if the holder of such claim had recourse against the debtor on account of such claim . . . unless [the creditor elects to treat the allowed claim as completely secured]." The Appellant claims that this provision prohibits discrimination in a reorganization plan on the basis of whether a claim is enforceable against the partners of a bankrupt partnership personally or not. Appellant's Brief at 18. This court declines to interpret Section 1111(b) as the Appellant would have it.

To take the Appellant's view would be to create a possible windfall for creditors in certain cases upon the filing of a bankruptcy petition, suddenly allowing them to collect from partners personally whereas before filing

they could seek repayment only from the partnership itself on their non-recourse loans.

The Appellee correctly notes that *Collier on Bankruptcy* takes the position that the recourse conversion provision of the Code should not change the status of non-recourse debt as it relates to the partners of a bankrupt partner ship. 5 *Collier on Bankruptcy* ¶ 1111.02, at 1111.23 (15th ed. 1990). If the section is not to create new liability for the partners themselves then, despite the filing of the bankruptcy petition, Travelers' claim would not be enforceable against any Bryson partner. It follows that whether the Third Plan mentioned the liability of partners for the other unsecured claims or not the partners would be liable for those claims and only those claims. To that extent, the references in the Third Plan to repayment of the remainder of certain unsecured claims by the partners are mere surplusage.

The Appellant might wish to respond that the court's interpretation renders Section 1111(b) meaningless, but that is not so. One scholar has explained the meaning of the Section 1111(b) conversion of claims to "recourse" status as having the effect of simply preventing secured claims which exceed the value of the collateral securing them from the strip-down provisions of Sections 502(b)(1) and 506 of Title 11.

> Recall that in a liquidation case under chapter 7, the holder of a nonrecourse claim has an allowed secured claim to the extent of the value of the collateral and no claim for any deficiency. However, in a reorganization case under chapter 11, the claim is allowed under section 1111(b) as if the creditor has recourse and the creditor is given an unsecured claim for the deficiency.

Klee, *All You Ever Wanted to Know About CramDown Under the New Bankruptcy Code*, 53 Am. Bankr. L.J. 133, 160 (1979) (footnotes omited). In other words,

were it not for Section 1111(b), Travelers could get nothing for the portion of its claim exceeding the value of the collateral. Section 1111(b) allows Travelers to either maintain its lien as fully secured or be allowed participation in the distribution of the estate's assets as an unsecured creditor (thus receiving 3.5% in this case). *See* 5 *Collier on Bankruptcy* ¶ 1111.02, at 1111-15 to 1111-28 (15th ed. 1990). Thus, the impact of the conversion to recourse status can be explained as having an effect on payment of claims in bankruptcy proceedings without changing the liability of a bankrupt partnership's partners.

The Third Plan may provide incidental benefits to the unsecured creditors who have persuaded Bryson's partners to reaffirm their obligations in the Plan. These special benefits which are not shared by all of the Debtor's unsecured creditors are not unreasonable, and this court holds that the Third Plan does not unfairly discriminate.

D. *The Third Plan is Fair and Equitable*

As mentioned above, to be confirmed despite the objection of any of a debtor's impaired creditors a Chapter 11 reorganization plan must in its treatment of both secured and unsecured claims be fair and equitable. 11 U.S.C. § 1129(b)(1). Travelers contends that the Third Plan is not fair and equitable because Bryson's partners, whose claims are inferior to Travelers' unsecured claim, will unjustly profit from a sale of Mid America Plaza and, more generally, because bankruptcy law protection should not cover "two-party disputes." The court rejects these claims.

1. *Unjust compensation and the new capital rule*

It is fair and logical for creditors to expect that junior claim-holders will not be paid by the estate while their own more senior claims go unsatisfied. This principle is embodied in the confirmation law's requirement that, with

respect to unsecured claims, no junior class of claims will "receive or retain on account of such junior claim or interest any property" (unless senior claims of dissenting creditors are first fully paid). 11 U.S.C. § 1129(b)(2)(B).

In this case, the Appellant claims that the Plan's provision for repayment of the infusion of fresh cash and the new credit line to the Bryson partners providing those resources, out of the proceeds of a sale of Mid America Plaza, violates the rule against paying junior claim holders ahead of senior ones (called the "absolute priority rule"). The Plan provides that upon any sale or refinancing of the buildings, the secured claim will be paid, after which the line of credit provided by partners of the Debtor and then their cash contribution (of $625,000.00) will be paid back.

Consistent with precedent, the court holds that the repayment of new investments into a struggling debtor does not run afoul of the absolute priority rule. 11 U.S.C. § 1129(b)(2)(B) guards against improper discrimination between existing creditors of the Debtor. Certainly those with superior claims should find support in the courts when they attempt to protect their interests. But contributors of additional money to an already bankrupt company who gain a right to payment in return for their new investments are not in any way cutting in front of superior creditors in the pay-back line. Rather, the new investors "share the risk of further loss and, in return, receive benefits." *Nimmer, Negotiated Bankruptcy Reorganization Plans: Absolute Priority and New Value Contributions*, 36 Emory L.J. 1009, 1050 (1987). Surely new investments into a struggling enterprise will not come if the investors cannot receive some interest in exchange for their investments. The rule advocated by the Appellant would foil the efforts of struggling businesses to gain new resources from those most willing to risk money on a once-failed venture—the people already

associated and familiar with the business. As one professor has explained,

> Superficially, there may appear to be little difference if the new capital comes from the original owners [who had junior claims but who may purchase a new interest in the business] or from new investors. But this apparent symmetry often does not exist. For example, the investments are not equally available from either source. New investors cannot easily be found, while the original owners are willing to take on a new risk to keep their business.

Id. at 1052. With this reasoning in mind, it is not surprising that courts have long held that old junior lienholders making new capital commitments are eligible for new interests in struggling businesses under both the old Bankruptcy Act of 1898 and the new Bankruptcy Code of 1978. In *Case v. Los Angeles Lumber Prod. Co.*, 308 U.S. 106, 121 (1939), Justice Douglas—a former S.E.C. head and expert on corporate fraud schemes—wrote (without dissent):

> It is, of course, clear that there are circumstances under which stockholders may participate in a plan of reorganization of an insolvent debtor. . . . [There is a] necessity, at times, of seeking new money 'essential to the success of the undertaking' from the old stockholders. Where that necessity exists and the old stockholders make a fresh contribution and receive in return a participation reasonably equivalent to their contribution, no objection can be made.

(footnote omitted).

Professor Nimmer recently wrote,

> Although developed under the former Bankruptcy Act, the new contribution concepts applies in Chapter 11 cases. Section 1129(b) prohibits owners from retaining or receiving property 'on account' of their

> prior interests unless creditors receive full value. In a new capital case, however, the source of the owners' interests in the reorganized company is their new contribution. Ownership is not retained 'on account' of the prior interest.

36 Emory L.J. at 1051 (footnote omitted). The Sixth Circuit used just such an analysis to find that there is no prohibition in the Bankruptcy Code against granting an interest to a contributor of new capital in its *U.S. Truck* case. *In re U.S. Truck Co.*, 800 F.2d 581, 588 (6th Cir. 1986) ("The question, put in terms of the Code's language, is whether McKinlay is receiving its interest in this reorganized company 'on account of' its junior claim. This involves looking at the need for the contribution and whether McKinley paid a fair price for its interest."). In an unpublished opinion, the Fourth Circuit also held that recognition in a reorganization plan of the interests of those who provide nourishment for a sick company to survive is consistent with the Bankruptcy Code. *Quality Inns Int'l, Inc. v. L.B.H. Assocs. Ltd.*, 911 F.2d 724 (4th Cir. 1990) ("Because the Class 14 claimants must make a contribution of 'money or money's worth' to retain their interest . . . and because these contributions are necessary to the success of the undertaking . . . the plan does not violate the absolute priority rule.") (text taken from WESTLAW).

It must, however, be noted that a wayward case from the Eighth Circuit—the first ever to hold, by a two-to-one vote, that a promise of future labor by the debtor is a sufficient contribution of new capital to evade absolute priority rule coverage—provoked the reversal of one circuit's approval of use of the new capital rule. In *In re Ahlers*, 794 F.2d 388 (8th Cir. 1986), the court held that a bankrupt farmer's promise to keep working and to apply his professional expertise to keep his farm liquid if allowed to reorganize was a contribution of new capital for which the farmer could gain a superior position to

that of his creditors. The dissenting judge on the Eighth Circuit offered four reasons against the majority's view. First, Judge Gibson said that a promise of future capital canont easily be turned to another use, and is therefore not liquid and comfort-giving to creditors of the reorganizing business. 794 F.2d at 407. Second, the value of a farmer's expertise is speculative, making it difficult for senior creditors to be assured that the labor contributor will not be overcompensated at their expense. *Id.* Furthermore, unlike payments which can be required of new capital contributors under the existing new capital rule, payment of new capital into the reorganizing business by one who will supply only labor or expertise cannot be assured prior to confirmation of a bankruptcy plan. *Id.* Finally, Judge Gibson reasoned that a labor-only contribution was inconsistent with what the Supreme Court intended the new capital rule to encompasse when it recognized the rule in 1939. *Id.* Adopting much of Judge Gibson's reasoning, the Supreme Court reversed the holding of the circuit court. *Northwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988). Moreover, it also observed that a new statutory scheme had been adopted since *Los Angeles Lumber* was decided, and then left open the question of whether the new capital rule had worn out its welcome at the Supreme Court. *Id.* at 203 n.3 ("Thus, our decision today should not be taken as any comment on the continuing vitality of the *Los Angeles Lumber*" new capital rule.).

Considering the Supreme Court's suggestion that the new Bankruptcy Code could have eliminated the new capital rule, and having reviewed the authorities discussed above, among others, the court believes that the reasoning used by Professor Nimmer and the Sixth Circuit should apply in this case. So long as the benefits provided by the contributor of necessary new capital under a reorganization plan do not exceed a reasonable estimation of the value of the new contribution, the absolute priority rule has not been violated.

The Appellant contends that even if the new capital rule survives it does not apply here because the contributors will receive in exchange a return "greater than their contribution." Appellant's Brief at 27. The court does not agree. As discussed above, the Plan provides only for possible reimbursement of the contributions of the new capital contributors, in amount and form identical to the contributions. The exchange is certainly not a return of something greater than the proposed new investment. Additionally, there is no question that new capital is needed here to pay for asbestos clean-up and the continued operation of the partnership. The new capital rule has therefore properly been applied by the bankruptcy court.

2. *Bankruptcy protection in two-party disputes*

Finally, Travelers contends that the third plan is not fair and equitable because it is involved in a two-party dispute with the Bryson partnership, and that bankruptcy protection here merely serves to allow the venture to renegotiate the terms of the Travelers' loan. Appellant's Brief at 21. The court finds the Appellant's argument unpersuasive.

Travelers' argument unmistakably falls into the category of claims discussed in the Fourth Circuit's opinion deciding *Carolin Corp. v. Miller*, 886 F.2d 693, 700-05 (4th Cir. 1989). There, the court said that determination of "whether the petitioner's real motivation is to 'abuse the reorganization process' " requires analysis of whether the bankruptcy petition was filed in bad faith. *Id.* at 702 (quoting *In re Thirtieth Place, Inc.*, 30 Bankr. 503, 505 [Bankr. 9th Cir. 1983]). Not surprisingly, in one of the two district court cases cited in support of the Appellant's abuse of bankruptcy argument, the claim is also treated as a question of bad faith. *In re Landmark Capital Co.*, 27 Bankr. 272, 279-81 (Bankr. D. Ariz. 1983). (The only other case cited by the Appellant for the proposition that this dispute should not be subject to bankruptcy law

resolution because it is a two-party dispute is a case in which a reorganization plan was not approved because one of the essential prerequisites to approval of a forced reorganization plan—approval of the plan by at least one class of impaired creditors—was not met. *In re Anderson Oaks (Phase I) Ltd.*, 77 Bankr. 108, 111 [Bankr. W.D. Tex. 1987]. In this case impaired classes of creditors have accepted the plan.)

The court will follow the mandate of *Carolin Corp.* and will treat the question of whether bankruptcy protection was invoked for an improper purpose as a question of bad faith. *Carolin Corp.* held that, in order to find that a proposed plan would be outside the scope of bankruptcy law coverage for want of good faith, "*both* objective futility [of rehabilitating the bankrupt debtor] and subjective bad faith [must] be shown." 886 F.2d at 700 (emphasis in original). The court added that a bad faith inquiry requires examination of the "totality of circumstances," and held that a bankruptcy court's finding that a filing was or was not in good faith would be reviewed subject to a clearly erroneous standard. *Id.* at 701-02.

In this case, the bankruptcy court disagreed with the Appellant, finding that bankruptcy protection was invoked in good faith. A major asbestos clean-up of Mid America Plaza must be undertaken, but once this effort is completed the Debtor should be in a healthier position. *Cf. Carolin Corp.*, 886 F.2d at 702 (holding company which had much unrented space in its fire-damaged property made no effort to repair property or to infuse new operating funds into the business, but sought the discharge of its debts and reorganization under Chapter 11). This court does not have an abundance of evidence as to the future profitability of the Bryson partnership, but the burden is on the Appellant to show that the bankruptcy court's finding of good faith was clearly erroneous, and it has not met that burden. Neither bad faith nor

futility has been proven, though both are prerequisite fiindings to a reversal of the bankruptcy court's finding of good faith.

This court therefore rejects the Appellant's claim that the reorganization plan is not fair and equitable because the Debtor entertained an improper motive.

CONCLUSION

The Supreme Court recently stated, "[A] central purpose of the Code is to provide a procedure by which certain insolvent debtors can reorder their affairs, make peace with their creditors, and enjoy a 'new opportunity in life with a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt.'" *Grogan v. Garner*, No. 89-1149 (Jan. 15, 1991) (quoting *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 [1934]). When a business in our interdependent commercial community becomes unable to pay its debt, it is an unfortunate reality that some entity must bear the expense of not being paid what it is owed. Here, Travelers' secured claim will be protected with payment of an equivalent to the present value of the claim. No unfair discrimination against Travelers' unsecured claim has been found, since the minor distinction in treatment of unsecured claims by the Third Plan is little more than a restatement of the reality that partners already bound for partnership liability must pay their debts. Travelers enjoys no similar right of action against individual partners to that of the holders of the other unsecured claims. Overall, this court believes that the bankruptcy court's determination that the Third Plan complied with the requirements of 11 U.S.C. § 1129 was not erroneous, as judged under the standards of review discussed above.

An order in accordance with this memorandum opinion shall be entered contemporaneously herewith.

/s/ Frank W. Bullock Jr.
United States District Judge

February 8, 1991

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF NORTH CAROLINA
GREENSBORO DIVISION

B-89-12311-C-11

IN RE BRYSON PROPERTIES XVIII

2:90CV00451

THE TRAVELERS INSURANCE COMPANY,
Plaintiff/Appellant,
v.

BRYSON PROPERTIES XVIII,
Defendant/Appellee.

ORDER

BULLOCK, District Judge

For the reasons set forth in the memorandum opinion filed contemporaneously herewith,

IT IS HEREBY ORDERED that the decision of the bankruptcy court be, and the same hereby is, AFFIRMED.

/s/ Frank W. Bullock Jr.
United States District Judge

February 8, 1991

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE MIDDLE DISTRICT OF NORTH CAROLINA
GREENSBORO DIVISION

Bankruptcy Case Number B-89-12311C-11
Chapter 11

IN RE: BRYSON PROPERTIES XVIII,
Debtor.

ORDER CONFIRMING PLAN

THE PLAN under Chapter 11 of the Bankruptcy Code filed by Bryson Properties XVIII, and designated Second Amended Plan of Reorganization, on April 9, 1990, which Plan was modified by a modification filed on June 18, 1990, and designated the Third Amended Plan of Reorganization, and such Second Amended Plan of Reorganization having been transmitted to creditors; and all classes other than Travelers Insurace Company having accepted the Second Amended Plan of Reorganization; and the Third Amended Plan of Reorganization, which amended the treatment of Travelers Insurance Company, having been transmitted to said creditor pursuant to the Order of this Court dated June 19, 1990; and

IT HAVING been determined after Hearing on Notice to Travelers Insurance Company that:

1. The Plan has been accepted in writing by the creditors and equity security holders whose acceptance is required by law; and

2. The provisions of Chapter 11 of the Code have been complied with; that the Plan has been proposed in good faith and not by means forbidden by law; and

3. Each holder of a claim or interest has accepted the Plan or will receive or retain under the Plan property

of a value, as of the effective date of the Plan, that is not less than the amount that such holder would receive or retain if the Debtor were liquidated under Chapter 7 of the Code on such date. The Plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interest that is impaired under, and has not accepted the Plan; and

4. All payments made or promised by the Debtor or by a person issuing securities or acquiring property under the Plan or by any other person for services or for costs and expenses in, or in connection with, the Plan and incident to the case, have been fully disclosed to the Court and are reasonable or, if to be fixed after Confirmation of the Plan, will be subject to the approval of the Court; and

5. The identity, qualification, and affiliations of the persons who are to be directors or officers, or voting trustee, if any, of the Debtor, after Confirmation of the Plan, have been fully disclosed, and the appointment of such persons to such officers, or their continuance therein, is equitable, and consistent with the interests of the creditors and equity security holders and with public policy; and

6. The identity of any insider that will be employed or retained by the Debtor and his compensation have been fully disclosed; and

7. Confirmation of the Plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the Debtor or any successor to the Debtor under the Plan:

IT IS ORDERED THAT: the Third Amended Plan of Reorganization filed by the Debtor on June 18, 1990, a copy of which plan is attached hereto, is confirmed.

BY THE COURT

/s/ Jerry G. Tart
Bankruptcy Judge

Supreme Court, U.S.
FILED
AUG 14 1992
OFFICE OF THE CLERK

No. 92-108

IN THE
Supreme Court of the United States
OCTOBER TERM, 1992

BRYSON PROPERTIES, XVIII,
Petitioner,

v.

THE TRAVELERS INSURANCE COMPANY,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

---

RESPONDENT'S BRIEF IN OPPOSITION

THOMAS BARNES HENSON *
ALLEN KEITH ROBERTSON
ROBINSON, BRADSHAW & HINSON, P.A.
1900 Independence Center
101 North Tryon Street
Charlotte, North Carolina 28246
(704) 377-2536

JOHN C. MURRAY
THE TRAVELERS COMPANIES
2215 York Road, Suite 504
Oak Brook, Illinois 60521
(708) 574-2200
Attorneys for Respondent

* Counsel of Record

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

QUESTIONS PRESENTED

1. Whether a Chapter 11 debtor in its plan of reorganization may classify the unsecured deficiency claim of a nonrecourse secured lender separately from other unsecured claims for the sole purpose of manipulating voting on the plan in order to gain access to the "cram down" provisions of 11 U.S.C. § 1129(b)?

2. Whether the plain language of 11 U.S.C. § 1129(b)(2)(B) prohibits confirmation of a plan of reorganization pursuant to which the partners of a partnership debtor will retain their ownership interests in the debtor even though unsecured creditors will not be paid in full?

RULE 29.1 LISTING

The Travelers Insurance Company is a corporation. The parent company of The Travelers Insurance Company is The Travelers Corporation, the stock of which is publicly traded. The Travelers Insurance Company has one partially-owned subsidiary, Applied Experts Systems, Inc.

TABLE OF CONTENTS

	Page
STATEMENT OF THE CASE	1
A. Proceedings in the Bankruptcy Court	2
B. Proceedings in the District Court	4
C. Proceedings in the Fourth Circuit	5
REASONS FOR DENYING THE WRIT	7
I. THE FOURTH CIRCUIT'S HOLDING ON THE CLASSIFICATION ISSUE DOES NOT CREATE A CONFLICT OF AUTHORITY WARRANTING THIS COURT'S ATTENTION	7
A. The Fourth Circuit's Holding Is Misstated in the Petition	8
B. Separate Classification of Unsecured Claims for the Sole Purpose of Manipulating Voting on a Plan is Prohibited by Every Circuit	9
II. THIS CASE IS NOT AN APPROPRIATE VEHICLE FOR ADDRESSING THE CONTINUED VIABILITY OF THE NEW CAPITAL EXCEPTION	14
A. There Is No Clear Conflict of Authority Among the Courts of Appeals on the Existence of the New Capital Exception	17
B. The Viability of the New Capital Exception Is Not Squarely Presented on the Facts of This Case	19
CONCLUSION	21

TABLE OF AUTHORITIES

CASES: Page

In re 222 Liberty Assocs., 108 B.R. 971 (Bankr. E.D. Pa. 1990) 18
In re Anderson, 913 F.2d 530 (8th Cir. 1990) 18, 19
Barnes v. Whelan, 689 F.2d 193 (D.C. Cir. 1982) .. 12
In re Bjolmes Realty Trust, 134 B.R. 1000 (Bankr. D. Mass. 1991) 18
In re Blankemeyer, 861 F.2d 192 (8th Cir. 1988) .. 18, 19
Case v. Los Angeles Lumber Products Co., 308 U.S. 106 (1939) 14, 15
In re D & F Construction, Inc., 865 F.2d 673 (5th Cir. 1989) 20
In re Drimmel, 135 B.R. 410 (D. Kan. 1991), *aff'g*, 108 B.R. 284 (Bankr. D. Kansas 1989) 17
Granada Wines, Inc. v. New England Teamsters and Trucking Industry Pension Fund, 748 F.2d 42 (1st Cir. 1984) 10, 11
In re Greystone III Joint Venture, 948 F.2d 134 (5th Cir. 1991) (as amended on rehearing) *petition for cert. filed*, No. 91-1902 (May 27, 1992) 5, 11, 13, 18
Hanson v. First Bank of South Dakota, N.A., 828 F.2d 1310 (8th Cir. 1987) 11, 12
In re Holywell Corp., 913 F.2d 873 (11th Cir. 1990) 11, 12
In re Jersey City Medical Center, 817 F.2d 1055 (3d Cir. 1987) 11, 12
Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting, 908 F.2d 1351 (7th Cir. 1990) 18
In re Lumber Exchange Bldg. Ltd. Partnership, 125 B.R. 1000 (Bankr. D. Minn. 1991) 17
In re Lumber Exchange Bldg. Ltd. Partnership, —— F.2d ——, 1992 WL 143303 (8th Cir. June 29, 1992) 11, 13, 19
In re Mason & Dixon Lines Inc., 63 B.R. 176 (Bankr. M.D.N.C. 1986) 12
In re Mortgage Investment Company of El Paso, Texas, 111 B.R. 604 (Bankr. W.D. Tex. 1990) 18
Norwest Bank Worthington v. Ahlers, 485 U.S. 197 (1988) 16, 20

TABLE OF AUTHORITIES—Continued

	Page
In re Outlook/Century, Ltd., 127 B.R. 650 (Bankr. N.D.Cal. 1991)	17
Patterson v. Shumate, —— U.S. ——, 112 S.Ct. 2242 (1992)	17
Piedmont Associates v. Cigna Property & Casualty Insurance Co., 132 B.R. 75 (N.D. Ga. 1991)	17
In re Professional Development Corp., 133 B.R. 425 (Bankr. W.D. Tenn. 1991)	18
In re Ribs Auto Sales, Inc., 140 B.R. 390 (Bankr. E.D. Va. 1992)	17
In re Rochem, Ltd., 58 B.R. 641 (Bankr. D.N.J. 1985)	12
In re SLC Ltd. V, 137 B.R. 847 (Bankr. D. Utah 1992)	18
In re Snyder, —— F.2d ——, 1992 WL 156687 (7th Cir. July 9, 1992)	18
In re Sovereign Group 1985-27, Ltd., —— B.R. ——, 1992 WL 172641 (E.D. Pa. June 30, 1992)	18
In re Tallahassee Associates, L.P., 132 B.R. 712 (Bankr. W.D. Pa. 1991)	18
In re Triple R Holdings L.P., 134 B.R. 382 (Bankr. N.D.Cal. 1991)	18
Union Bank v. Wolas, —— U.S. ——, 112 S.Ct. 527 (1991)	17
In re U.S. Truck Company, Inc., 800 F.2d 581 (6th Cir. 1986)	10, 12, 17
In re Winters, 99 B.R. 658 (Bankr. W.D. Pa. 1989)	14, 18
In re Woodscape Limited Partnership, 134 B.R. 165 (Bankr. D. Md. 1991)	18
STATUTES:	
11 U.S.C. § 506(a)	2
11 U.S.C. § 1111(b)	2
11 U.S.C. § 1122	9, 10
11 U.S.C. § 1126(c)	16
11 U.S.C. § 1129(a)	15
11 U.S.C. § 1129(a)(7)	15

TABLE OF AUTHORITIES—Continued

	Page
11 U.S.C. § 1129(a)(10)	4
11 U.S.C. § 1129(b)	16
11 U.S.C. § 1129(b)(1)	4
11 U.S.C. § 1129(b)(2)	15, 20
11 U.S.C. § 1129(b)(2)(B)	15
OTHER AUTHORITIES:	
5 *Collier on Bankruptcy*, ¶ 1122.03 (15th ed. 1992)	10
5 *Collier on Bankruptcy*, ¶ 1129.03 (15th ed. 1992)	20
S. Rep. No. 989, 95th Cong., 2d Sess. 118 (1978), *reprinted in* 1978 *U.S. Code Cong. & Admin. News* 5787, 5904	10
Sup. Ct. R. 10	17, 18

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

No. 92-108

BRYSON PROPERTIES, XVIII,
Petitioner,

v.

THE TRAVELERS INSURANCE COMPANY,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

---

RESPONDENT'S BRIEF IN OPPOSITION

STATEMENT OF THE CASE

Petitioner Bryson Properties, XVIII the "Debtor"), the debtor in a Chapter 11 bankruptcy case, has asked this Court to review the opinion and judgment of a unanimous panel of the Court of Appeals for the Fourth Circuit, which reversed confirmation of the Debtor's Third Amended Plan of Reorganization (the "Plan") because the Plan's treatment of Respondent The Travelers Insurance Company ("Travelers") is not "fair and equitable" within the meaning of 11 U.S.C. § 1129(b). App. at 2a.[1]

---

[1] "App." means the Appendix to the Petition for Writ of Certiorari filed with this Court; "J.A." means the Joint Appendix filed with the United States Court of Appeals for the Fourth Circuit.

A. Proceedings in the Bankruptcy Court.

The Debtor is a limited partnership organized under Illinois law, with the principal place of business of its general partner now located in Durham, North Carolina. The Debtor purchased its sole asset, a complex of three comercial office buildings in Omaha, Nebraska, known as "Mid America Plaza," in November, 1986. The Debtor bought Mid America Plaza subject to a first mortgage in favor of Travelers and assumed the seller's obligations to Travelers under a ten-year nonrecourse promissory note in the original principal amount of $10,800,000, which is due and payable in full on June 1, 1995.

The Debtor paid Travelers according to the terms of the note for approximately three years, then defaulted. The Debtor has not made any payments required under the note since June 1, 1989. J.A. at 14.

In September, 1989, after losing an anchor tenant, discovering asbestos in all three of its buildings, experiencing a soft real estate market in Omaha, and receiving notice from Travelers of its intent to commence foreclosure proceedings, the Debtor filed a voluntary petition to reorganize under Chapter 11 of the Bankruptcy Code with the United States Bankruptcy Court for the Middle District of North Carolina.

As of the commencement of this case the Debtor owed Travelers $11,234,306. J.A. at 14. In February 1990 the Bankruptcy Court valued the Debtor's interest in Mid America Plaza at $7,905,068. *See* J.A. at 47. The Bankruptcy Code provides that Travelers' secured claim is limited to the value of the Debtor's interest in Mid America Plaza. 11 U.S.C. § 506(a). In Chapter 11 Travelers is also allowed an unsecured claim against the Debtor equal to the amount of its deficiency, $3,329,238.[2] 11 U.S.C. § 1111(b).

---

[2] Outside of bankruptcy Travelers would not have a deficiency claim against the Debtor under the terms of its nonrecourse note.

In the Plan the Debtor divides claims and interests into eight numbered classes: (1) administrative expenses; (2) tenant security deposits; (3) secured tax claims; (4) Travelers' secured claim; (5) the unsecured claim of Continental Bank; (6) the unsecured claims of trade creditors; (7) Travelers' unsecured claim; and (8) equity interests of the Debtor's partners. J.A. at 123-24. The Debtor proposes to pay administrative expenses, tenant deposits and tax claims in full. J.A. at 126-27.

In the Plan the Debtor proposes to pay only interest on Travelers' Class 4 secured claim at rates ranging from 9.25% to 10.5% for ten years, with a balloon payment of the allowed amount of Travelers' secured claim and accrued interest, approximately $8,126,014, at the end of the ten-year period. The Debtor also proposes to pay 3.5% of the allowed amount of all unsecured claims in full satisfaction of those claims; however, because one of the Debtor's limited partners guaranteed payment of Continental Bank's unsecured claim and the Debtor's general partner is liable to trade creditors under applicable state law, the Plan also states that the balance of all unsecured claims except Travelers would be paid in full by the Debtor's partners within thirty days of confirmation of the Plan.

Even though Travelers' unsecured claim will not be paid in full under the Plan, the Debtor proposes that its partners retain their equity ownership interests by making a new capital contribution to the Debtor consisting of $625,000 in cash and providing for an $850,000 line of credit. Only if Mid America Plaza is sold within ten years will Travelers receive a limited return on its claims, and then only after the Debtor's partners have recouped their new "investment." [3]

---

[3] If the property is sold or refinanced within ten years, Travelers will receive thirty-three percent (33%) of the proceeds from the sale or refinancing after deducting the following: payment of $7,905,068 to Travelers, the outstanding balance of its secured

Travelers objected to confirmation of the Plan for many reasons, including the Debtor's separate classification of unsecured claims and the retention by the Debtor's partners of their ownership interests even though Travelers' unsecured claim would not be paid in full.

In June, 1990, at the hearing on confirmation of the Plan, the Debtor did not present any evidence justifying separate classification of Travelers' unsecured claim. *See* J.A. at 144-70; *see also* J.A. at 49-117 (transcript of hearing on confirmation of Debtor's Second Amended Plan of Reorganization). Nevertheless, the Bankruptcy Court concluded that separate classification of Travelers' unsecured claim was proper and that the Plan's treatment of Travelers was "fair and equitable." J.A. at 169. The Court then confirmed the Plan under the "cram down" provisions of 11 U.S.C. § 1129(b).[4] *Id.* On June 26, 1990, the Bankruptcy Court entered an order confirming the Plan which contained no specific factual findings, but concluded that the Plan's treatment of Travelers' claims was "fair and equitable" and not "unfairly discriminatory." App. at 37a-38a.

B. Proceedings in the District Court.

Travelers appealed from the order confirming the Plan to the United States District Court for the Middle District of North Carolina. On February 8, 1991, the Dis-

---

claim; payment of the $850,000 line of credit to be made available by the Debtor's partners; payment of the $625,000 equity contribution to be made by the Debtor's partners; and payment to Travelers of any difference between the principal balance shown on an amortization schedule attached to the Plan (amortizing the original loan amount of $10,800,000 at 5.25%) and the balance of the secured claim. J.A. at 128-29.

[4] Before a plan can be crammed down, at least one noninsider impaired class of claims must vote to accept it. 11 U.S.C. §§ 1129(a)(10), 1129(b)(1). Unsecured creditors in Classes 5 and 6 voted to accept the Plan, thus satisfying this requirement if separate classification of unsecured claims was proper.

trict Court entered a memorandum opinion and order affirming confirmation of the Plan. 129 B.R. 440 (M.D.N.C. 1991) (*reprinted in* App. at 17a-36a).

C. Proceedings in the Fourth Circuit.

Travelers appealed from the District Court's order affirming confirmation of the Plan to the Court of Appeals for the Fourth Circuit. On April 20, 1992, a unanimous panel of the Fourth Circuit reversed the District Court's order affirming confirmation of the Plan, and remanded this case to the Bankruptcy Court for further findings consistent with its opinion. 961 F.2d 496 (4th Cir. 1992) (*reprinted in* App. at 1a-16a).

Reviewing the Plan's treatment of Travelers' unsecured claim, the Fourth Circuit first addressed whether the Debtor's separate classification of Travelers' Code-created unsecured deficiency claim and other unsecured claims was proper under the Code. The Court held that while the Bankruptcy Code "does not . . . require that all substantially similar claims be placed within the same class," App. at 9a, a debtor may not classify similar claims separately for the purpose of manipulating voting on a plan. App. at 10a. The Court then held that the justification offered in this case for separate classification —that Travelers' unsecured claim arises from a nonrecourse obligation, whereas other unsecured claims arise from recourse loans—was insufficient to withstand scrutiny. Citing *In re Greystone III Joint Venture*, 948 F.2d 134, 140 (5th Cir. 1991) (as amended on rehearing), *petition for cert. filed*, No. 91-1902 (May 27, 1992), the Court of Appeals pointed out that the distinction between Code-created unsecured deficiency claims and other unsecured claims does not warrant separate classification. App. at 10a. Even if that distinction did warrant separate classification, the Fourth Circuit concluded that "[w]here all unsecured claims receive the same treatment in terms of Plan distribution, separate classification on

the basis of natural and unnatural recourse claims is, at a minimum, highly suspect." *Id.* Because the Debtor failed to offer any other ground to justify classifying Travelers' claim separately from other unsecured claims, the Fourth Circuit held that the classification was "clearly for the purpose of manipulating voting" and "may not stand." *Id.* at 10a-11a.

The Fourth Circuit also addressed Travelers' argument that the plan violated the absolute priority rule, as codified in 11 U.S.C. § 1129(b)(2)(B)(ii), "for the sake of judicial economy." App. at 11a. After reviewing the history of the development of the "new capital exception" in cases decided under the Bankruptcy Act of 1898, the current division among the district courts and bankruptcy courts as to whether the "new capital exception" survived codification of the absolute priority rule in § 1129(b), legislative history and bankruptcy policy, the Court concluded that "the plain words of the statute provide an answer *under the particular facts of this case.*" App. at 11a-14a (emphasis added). Concluding that the exclusive right of the Debtor's partners to contribute new capital constitutes "property" which was received on account of a prior interest, the Fourth Circuit held that the Plan could not be confirmed over Travelers' objection because the Plan did not provide that Travelers' unsecured claim would be paid in full. App. at 15a.

In addition to the analysis of the minimum standard of "fair and equitable" treatment of unsecured claims contained in 11 U.S.C. § 1129(b)(2)(B), the Court of Appeals also held that bankruptcy courts must closely scrutinize plans which only adjust the interests of one creditor under the "broad sense" of the fair and equitable standard of 11 U.S.C. § 1129(b). Under the Plan or through outside payments, all creditors, except Travelers, will be paid in full. Because only Travelers is truly impaired under the Plan, the Fourth Circuit held that "even if some limited new capital exception were viable under the Bankruptcy Code, it would not be so expansive as to apply

under the facts of this case." App. at 16a (emphasis added).

REASONS FOR DENYING THE WRIT

The Debtor presents two questions for review by this Court in the petition: whether under 11 U.S.C. § 1122(a) unsecured claims must be classified together in a Chapter 11 plan of reorganization, and whether the new capital exception to the absolute priority rule survived enactment of the Bankruptcy Code in 1978. The Court should refuse to review the classification question presented by the Debtor because the Fourth Circuit did not hold that unsecured claims always must be classified together. Instead, like each and every other circuit which has addresed the question, the Fourth Circuit held that unsecured claims may not be classified separately for the purpose of manipulating voting on a plan of reorganization. Moreover, the Court should not take this case to decide the question of the viability of the new capital exception under the Bankruptcy Code, because the issue is not ripe for review and, even if it were, this case would not be an appropriate vehicle to address it.

I. THE FOURTH CIRCUIT'S HOLDING ON THE CLASSIFICATION ISSUE DOES NOT CREATE A CONFLICT OF AUTHORITY WARRANTING THIS COURT'S ATTENTION.

In the petition the Debtor urges the Court to review this case because the Fourth Circuit supposedly has adopted a "restrictive" approach to classification of claims in Chapter 11 plans of reorganization. The Debtor would have this Court believe that in conflict with a "flexible" approach enunciated by the Sixth, District of Columbia and Third Circuits, the Fourth Circuit has held that all unsecured claims must be classified together. Petition at 17-18, 20. Contrary to the Debtor's characterization of the decision below, the Fourth Circuit expressly stated in its opinion that 11 U.S.C. § 1122 does *not* require that all

unsecured claims be classified together. Instead, the Fourth Circuit held only that separate classification of unsecured claims for the sole purpose of manipulating voting on a plan of reorganization is forbidden. App. 9a-11a. The Fourth Circuit's decision is entirely consistent with the Debtor's so-called "flexible" approach to classification adopted by the Sixth, District of Columbia and Third Circuits. Therefore, review by this Court of the first question posed by the petition is unnecessary.

A. The Fourth Circuit's Holding Is Misstated in the Petition.

In an attempt to create a conflict between circuits where none exists, the Debtor misstates the Fourth Circuit's holding on separate classification of unsecured claims at several points in the petition. In the first question presented, the Debtor asks this Court to review whether the Fourth Circuit erred "by creating the requirement that all unsecured claims must be classified together where no such requirement exists in the Bankruptcy Code." Petition at i. Later in its petition, the Debtor compounds its error by arguing that:

> By requiring that *all unsecured claims be classified together*, the First, *Fourth* and Fifth Circuits have significantly undermined the negotiation process of Chapter 11 reorganization and placed control in the hands of the large under secured creditor.

Petition at 20 (emphasis added).

Contrary to the Debtor's misreading of the Fourth Circuit's decision, the Fourth Circuit expressly interpreted the requirements of 11 U.S.C. § 1122 as follows:

> Section 1122 requires substantial similarity between claims that are placed in the same class. *It does not, however, require that all substantially similar claims be placed within the same class*, and it grants some flexibility in classification of unsecured claims.

App. at 9a (emphasis added). Recognizing that there is a limit on a debtor's power to classify claims, the Court of Appeals examined the facts of this case and concluded that the Plan's separate classification of unsecured claims was solely for the purpose of manipulating voting on the Plan. App. at 10a-11a. Because the purpose of separate classification was to manipulate voting, the Fourth Circuit held that the classification scheme in the Plan was improper and "may not stand." App. at 11a.

Contrary to the Debtor's assertions, the Fourth Circuit did not hold that all unsecured claims must be classified together in all Chapter 11 plans of reorganization. Therefore, this case does not even raise the first question posed by the petition. For that reason alone, this Court should decline to review that question.

B. Separate Classification of Unsecured Claims for the Sole Purpose of Manipulating Voting on a Plan Is Prohibited by Every Circuit.

As the Fourth Circuit correctly observed, classification of claims or interests is governed by 11 U.S.C. § 1122. That section reads:

> (a) Except as provided in subsection (b) of this section, a plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class.
>
> (b) A plan may designate a separate class of claims consisting only of every unsecured claim that is less than or reduced to an amount that the court approves as reasonable and necessary for administrative convenience.

11 U.S.C. § 1122.

Because the primary thrust of § 1122 is to insure that claims or interests which are not substantially similar are placed in separate classes, a number of classification rules

are easy to understand. For example, because the claims of creditors and the interests of equity holders are inherently dissimilar, they must be classified separately. 5 *Collier on Bankruptcy*, ¶ 1122.03 at 1122-07 (15th ed. 1992). A plan of reorganization also must separately classify secured claims, priority unsecured claims and nonpriority unsecured claims. *Id.* at 1122-10.

The plain language of § 1122 does not specify whether all claims which are substantially similar, such as unsecured claims, must be placed together in one class. The leading case on this issue is *In re U.S. Truck Company, Inc.*, 800 F.2d 581, 584-87 (6th Cir. 1986). Because the legislative history accompanying § 1122 makes reference to codification of "current case law surrounding the classification of claims and equity securities," S. Rep. No. 989, 95th Cong., 2d Sess. 118 (1978), *reprinted in* 1978 *U.S. Cong. & Admin. News* 5787, 5904, the Sixth Circuit looked to pre-Code case law decided under the Bankruptcy Act of 1898[5] to resolve this question. Because cases interpreting Chapter X of the Act required that similar claims be classified together, while cases interpreting Chapter XI of the Act did not, the Sixth Circuit concluded that debtors may classify similar claims, such as unsecured claims, separately. *Id.* Since the Sixth Circuit decision in *U.S. Truck*, all of the courts of appeals, including the Fourth Circuit in the decision below, which have considered the propriety of separately classifying unsecured claims have concluded that it is not prohibited under § 1122.[6] App. at 9a ("[§ 1122] does not . . . require that

---

[5] The Bankruptcy Act was replaced in its entirety in 1978 by the enactment of the Bankruptcy Code, 11 U.S.C. § 101 *et seq.*

[6] The Debtor argues that the United States Court of Appeals for the First Circuit strictly requires that all unsecured claims be classified together. *See Granada Wines, Inc. v. New England Teamsters and Trucking Industry Pension Fund*, 748 F.2d 42 (1st Cir. 1984). Citing case law decided under Chapter X of the Bankruptcy Act of 1898, the First Circuit in *Granada Wines* held that "[s]eparate classifications for unsecured creditors are only justified 'where the

all substantially similar claims be placed within the same class, and it grants some flexibility in classification of unsecured claims"); *Greystone*, 948 F.2d at 138 ("One cannot conclude categorically that § 1122(a) prohibits the formation of different classes from similar types of claims"); *In re Holywell Corp.*, 913 F.2d 873, 880 (11th Cir. 1990) (". . . proponent of a plan of reorganization has considerable discretion to classify claims and interests according to the facts and circumstances of the case . . ."); *Hanson v. First Bank of South Dakota, N.A.*, 828 F.2d 1310, 1313 (8th Cir. 1987) ("We agree that 11 U.S.C. § 1122(a) does not prohibit the placement of substantially similar claims in different classes"); *In re Jersey City Medical Center*, 817 F.2d 1055, 1060-61 (3d Cir. 1987) ("We agree with the general view which permits the grouping of similar claims in different classes").

No circuit supports the Debtor's contention in this case that a debtor should have unfettered discretion to classify unsecured claims separately. The Fifth Circuit in *Greystone* concluded that there is "one clear rule" which has emerged from the fact-based case law on classification: "Thou shalt not classify similar claims differently in order to gerrymander an affirmative vote on a reorganization plan." 948 F.2d at 139; *see also In re Lumber Exchange Bldg. Ltd. Partnership*, —— F.2d ——, 1992 WL 143303, *1 (8th Cir. June 29, 1992) (*citing Greystone* with approval). As the Eleventh Circuit explained in *Holywell*:

---

legal character of their claims is such as to accord them a status different from the other unsecured creditors . . . .'" 748 F.2d at 46. The First Circuit then concluded that separate classification of an unsecured claim against an employer for withdrawal from a multiemployer pension plan was improper because it has the same legal character as other unsecured claims. 748 F.2d at 46-47. Thus, like the other circuits, even the First Circuit allows separate classification of unsecured claims if the legal character of an unsecured claim is different than the character of other unsecured claims in a particular case.

> If the plan unfairly creates too many or too few classes, if the classifications are designed to manipulate class voting, or if the classification scheme violates basic priority rights, the plan cannot be confirmed.

913 F.2d at 880; *see also Hanson*, 828 F.2d at 1313 ("Classifications designed to manipulate class voting must be carefully scrutinized"). Moreover, the decisions of the Sixth and Third Circuits, which the Debtor would have the Court to believe are in conflict with the decision below, also recognize that there are limits on a debtor's ability to classify claims. *U.S. Truck*, 800 F.2d at 586 ("Unless there is some requirement of keeping similar claims together, nothing would stand in the way of a debtor seeking out a few impaired creditors (or even one such creditor) who will vote for the plan and placing them in their own class"); *Jersey City Medical Center*, 817 F.2d at 1061 (citing *U.S. Truck* and holding that "classification of claims or interests must be reasonable").

In this case the Debtor's sole argument for separately classifying Travelers' unsecured claim from the other unsecured claims is that Travelers' unsecured claim arises from a nonrecourse obligation and the holders of other unsecured claims have recourse against the Debtor and its partners. The courts have found that certain types of unsecured claims are legally distinct and may be separately classified. *Barnes v. Whelan*, 689 F.2d 193, 201 (D.C. Cir. 1982) (distinguishing unsecured creditors/unsecured creditors with claims against a codebtor); *U.S. Truck*, 800 F.2d at 584-87 (distinguishing unsecured trade creditors/union's unsecured claim from rejection of collective bargaining agreement); *In re Mason & Dixon Lines Inc.*, 63 B.R. 176, 179-81 (Bankr. M.D.N.C. 1986) (distinguishing unsecured creditors/pension claimants); *In re Rochem, Ltd.*, 58 B.R. 641 (Bankr. D.N.J. 1985) (distinguishing unsecured trade creditors/tort claimants). One distinction which the circuit courts have agreed does *not* warrant separate classification is that between trade

creditors and unsecured deficiency claims of nonrecourse lenders. *Lumber Exchange*, —— F.2d ——, 1992 WL 143303, *1 ("How the claims of MONY [a nonrecourse lender] and the trade creditors achieved their status does not alter their current legal character and thus does not warrant separate classification"); *Greystone*, 948 F.2d at 140 ("The state law distinction between Code-created unsecured deficiency claims [of a nonrecourse lender] and other unsecured claims does not alone warrant separate classification").

Citing *Greystone*, the Fourth Circuit pointed out that the distinction between a Code-created deficiency claim of a nonrecourse lender and other unsecured claims does not warrant separate classification. There is no contrary circuit court authority on this issue. In addition, leaving aside the question of the legal similarity of such claims, the Fourth Circuit also concluded that separate classification of deficiency claims and trade claims is "highly suspect" where all unsecured claims receive the same distribution under a plan. Presented with no reason for separate classification of claims which "will withstand scrutiny," the Fourth Circuit held that the Debtor's separate classification of Travelers' unsecured claim "is clearly for the purpose of manipulating voting and it may not stand." App. at 10a-11a.

The Fourth Circuit's decision on the classification issue posed by the petition is consistent with the decisions of other circuits recognizing generally that § 1122 allows similar claims to be placed in separate classes, but concluding that separate classification of similar claims for the purpose of manipulating voting is improper. The Fourth Circuit's decision, which is based on the facts of this case, does not create a conflict of authority worthy of this Court's attention. The Court should deny the requested writ to review this question.

II. THIS CASE IS NOT AN APPROPRIATE VEHICLE FOR ADDRESSING THE CONTINUED VIABILITY OF THE NEW CAPITAL EXCEPTION.

The Debtor argues that review of the second question presented by the petition, whether the new capital exception to the absolute priority rule survived enactment of the Bankruptcy Code in 1978, is required because a "definitive decision from this Court on this unanswered question is essential to resolve the conflict which sharply divides the circuits and lower courts." Petition at 21. The Court should decline to review the second question presented because this issue is not ripe for review by this Court and because the issue is not squarely presented on the facts of this case.

In *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939), this Court held that a plan of reorganization was not "fair and equitable" within the meaning of the Bankruptcy Act if it allowed the debtor's owners to retain their interests in the reorganized debtor without first paying all creditor claims in full. This holding is now simply referred to as the "absolute priority rule." Under the Act, the absolute priority rule applied to all classes of claims in a plan, including those classes which had voted to accept the plan, if even one creditor dissented. *See Los Angeles Lumber*, 308 U.S. at 114. Therefore, under the Act the only way in which equity holders could retain an ownership interest in the reorganized debtor without paying senior classes in full was through unanimous approval of the plan by all creditors. *See In re Winters*, 99 B.R. 658, 662 (Bankr. W.D. Pa. 1989). It was in the context of the Act, under which even a single dissenting creditor could prevent any continuing equity participation absent payment in full, that this Court suggested an exception to the absolute priority rule. The *Los Angeles Lumber*. Court wrote:

> Where [the] necessity exists and the old stockholders make a fresh contribution and receive in return a

> participation reasonably equivalent to their contribution, no objection can be made.

308 U.S. at 121. This came to be known as the "new capital exception" or the "new value exception" to the absolute priority rule. This "exception" allowed equity holders their only opportunity under the Act to retain their ownership interests, when necessary to a successful reorganization, over the objection of creditors.

When Congress enacted the Bankruptcy Code in 1978, it codified the absolute priority rule with some significant modifications as part of the cram down provisions contained in 11 U.S.C. § 1129(b)(2). Specifically, under § 1129(b)(2)(B), a plan cannot be confirmed over the objection of a class of unsecured claims, unless the plan provides: (i) that the holder of each claim in the objecting class receive or retain property of a value equal to the allowed amount of such claim on the effective date of the plan, or (ii) that the holder of any claim or interest junior to the claims of such class will not receive or retain under the plan any property.

The most notable change in the absolute priority rule as codified is that, as part of the cram down provisions, it now applies only to members of a rejecting impaired *class* of claims or interests, not to individual claims. As long as all impaired classes of claims or interests vote to accept a plan, the plan may be confirmed under § 1129(a) and a dissenting creditor in an accepting class cannot invoke the absolute priority rule.[7] Thus, unlike the situation under the Act, a plan which proposes to allow equity holders to retain their interests even though one or more senior classes is not being paid in full may be confirmed under the Code even if a dissenting creditor is present, if the class containing the disenting creditor has accepted

---

[7] The proponent of a plan still must demonstrate that a dissenting creditor in an accepting class will receive at least as much as it would receive in a Chapter 7 bankruptcy case. 11 U.S.C. § 1129(a)(7).

the plan.[8] In light of the Code's substantial modification of the absolute priority rule as applied under the Act, it is not surprising that the new capital exception does not appear in § 1129(b) or in any other provision in the Bankruptcy Code.

In *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988), this Court declined to decide whether the new capital exception survived the enactment of the Bankruptcy Code in 1978.

> We need not reach this question [of the continuing vitality of the exception] to resolve the instant dispute . . . we think it clear that even if the *Los Angeles Lumber* exception to the absolute priority rule has survived enactment of the Bankruptcy Code, this exception does not encompass respondents' promise to contribute their "labor, experience and expertise" to the reorganized enterprise. Thus, our decision today should not be taken as any comment on the continuing vitality of the *Los Angeles Lumber* exception—a question which has divided the lower courts since passage of the Code in 1978. [Citations omitted.] Rather, we simply conclude that even if an "infusion of 'money-or-money's-worth' " exception to the absolute priority rule has survived the enactment of § 1129(b), respondents' proposed contribution to the reorganization plan is inadequate to gain the benefit of this exception.

485 U.S. at 203 n.3. For the reasons discussed below, the question left unanswered in *Ahlers* is not yet ripe for consideration by this Court.

---

[8] A class of claims is deemed to have accepted a plan if creditors holding two-thirds in amount and a majority in number of the claims in that class which are voted accept the plan. 11 U.S.C. § 1126(c).

A. There Is No Clear Conflict of Authority Among the Courts of Appeals on the Existence of the New Capital Exception.

One of the principal considerations in this Court's decision to exercise its discretion to review a case on writ of certiorari is whether the decision below conflicts with a decision of another circuit on the same matter. Sup. Ct. R. 10. Because there is currently no conflict among the circuits on the question of the continued vitality of the new capital exception, the second question presented is not ripe for review by this Court.[9]

Prior to this Court's decision in *Ahlers*, the Sixth Circuit applied the new capital exception in a case before it without discussing the effect of the adoption of the Bankruptcy Code on the exception. *U.S. Truck*, 800 F.2d at 588. Since the decision in *Ahlers*, however, the courts of appeals have been reluctant to rule on the viability of the new capital exception.[10] For example, in 1990, Judge

---

[9] The Fourth Circuit's application of the plain meaning of the language of § 1129(b)(2)(B) based on the facts of this case is, in any event, consistent with recent decisions of this Court regarding interpretation of the Bankruptcy Code. *E.g., Patterson v. Shumate*, —— U.S. ——, 112 S.Ct. 2242, 2246 (1992) ("In our view, the plain language of the Bankruptcy Code . . . is our determinant") (citation omitted); *Union Bank v. Wolas*, —— U.S. ——, 112 S.Ct. 527, 531 (1991) ("The fact that Congress may not have foreseen all of the consequences of a statutory enactment is not a sufficient reason for refusing to give effect to its plain meaning").

[10] Since this Court's decision in *Ahlers*, a number of district courts and bankruptcy courts have considered whether the new capital exception survived adoption of the Bankruptcy Code, with varying results. *Compare e.g., In re Ribs Auto Sales, Inc.*, 140 B.R. 390, 395-96 (Bankr. E.D. Va. 1992) (exception does not exist); *In re Drimmel*, 135 B.R. 410, 415-17 (D. Kan. 1991) (same), *aff'g*, 108 B.R. 284 (Bankr. D. Kan. 1989); *Piedmont Associates v. Cigna Property & Casualty Insurance Co.*, 132 B.R. 75, 79 (N.D. Ga. 1991) (same); *In re Outlook/Century, Ltd.*, 127 B.R. 650, 654-58 (Bankr. N.D.Cal. 1991) (same); *In re Lumber Exchange Limited Partnership*, 125 B.R. 1000, 1006-08 (Bankr. D. Minn. 1991) (same), *aff'd on other grounds*, —— F.2d ——, 1992 WL 143303 (8th Cir.

Easterbrook of the Court of Appeals for the Seventh Circuit undertook a thorough, scholarly analysis of the history of the new value exception, suggested that the new value exception vanished in 1978, but stopped short of that holding. *Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting*, 908 F.2d 1351, 1359-62 (7th Cir. 1990). The question remains open in the Seventh Circuit. *In re Snyder*, —— F.2d ——, 1992 WL 156687 (7th Cir. July 9, 1992) (dicta discussing the continued viability of exception, but reserving question for "another day"). In November 1991, Judge Edith Jones, writing for a unanimous panel of the Fifth Circuit, concluded that the new value exception does not exist under the Bankruptcy Code; however, on rehearing in February 1992, the other two members of the panel reversed course and withdrew the portion of the panel opinion on the new value exception over Judge Jones' dissent. *Greystone*, 948 F.2d 134 (as amended).

Since the decision in *Ahlers*, the Eighth Circuit has decided two cases which have assumed the new capital exception's vitality without a discussion of its viability under the Bankruptcy Code. *In re Anderson*, 913 F.2d 530 (8th Cir. 1990); *In re Blankemeyer*, 861 F.2d 192

June 29, 1992); *Winters*, 99 B.R. at 662-63 (Bankr. W.D. Pa. 1989) (same), *with e.g., In re Sovereign Group 1985-27, Ltd.*, —— B.R. ——, 1992 WL 172641, *2-3 (E.D. Pa. June 30, 1992) (exception survived the enactment of the Code); *In re SLC Ltd. V*, 137 B.R. 847, 850-55 (Bankr. D. Utah 1992) (same); *In re Bjolmes Realty Trust*, 134 B.R. 1000, 1004-08 (Bankr. D. Mass. 1991) (same); *In re Triple R Holdings L.P.*, 134 B.R. 382, 389-92 (Bankr. N.D.Cal. 1991) (same); *In re Woodscape Limited Partnership*, 134 B.R. 165, 168-75 (Bankr. D. Md. 1991) (same); *In re Professional Development Corp.*, 133 B.R. 425, 428 (Bankr. W.D. Tenn. 1991) (same); *In re Tallahassee Associates*, L.P., 132 B.R. 712, 715-17 (Bankr. W.D. Pa. 1991) (same); *In re Mortgage Investment Company of El Paso, Texas*, 111 B.R. 604, 618 (Bankr. W.D. Tex. 1990) (same); *In re 222 Liberty Assocs.*, 108 B.R. 971, 983-85 (Bankr. E.D. Pa. 1990) (same). Conflict among the district courts, however, has never been viewed as a persuasive reason for the exercise of this Court's certiorari jurisdiction. *See* Sup. Ct. R. 10.

(8th Cir. 1988). In *Anderson*, the Eighth Court affirmed the district court's decision to lift the automatic stay because the debtor had not produced evidence sufficient to establish a reasonable probability of a successful reorganization, and noted without comment the district court's holding that the exception existed. 913 F.2d at 532-33. In *Blankemeyer*, the debtor proposed a plan whereby its equity holders would retain their interests in the debtor, and the Eighth Circuit affirmed, without comment, the district court's finding that the equity holders were not contributing "something reasonably compensatory and measurable to the reorganization enterprise." 861 F.2d at 194. Nevertheless, a recent Eighth Circuit decision suggests that the question remains open in that Court. *Lumber Exchange*, —— F.2d ——, 1992 WL 143303, *4 ("Having concluded that Lumber Exchange's plan would not be confirmable without improperly classifying the creditors, we need not address the absolute priority rule, the viability of the new vaiue exception, or whether the plan would be fair and equitable").

In sum, there is hardly a split of authority, much less a clear split of authority, at the circuit level on the second question presented by the petition. Unless and until a clear split of authority between the circuits on the viability of the new capital exception emerges, this Court should defer its consideration of the question.

B. The Viability of the New Capital Exception Is Not Squarely Presented on the Facts of This Case.

Even if there were a legitimate conflict among the circuits on the issue of the continued viability of the new capital exception, this case would not be an appropriate vehicle in which to resolve that question. First and foremost, the viability of the new capital exception is not an issue which is squarely presented by the facts of this case. As the Fourth Circuit held, *even if the new capital exception existed*, it would not apply under the facts of

this case. App. at 16a. For this reason, the issue of the exception's continued validity is not squarely presented here. The Court should defer its review of the existence of the new capital exception until confronted with a circuit decision which squarely presents the issue.

Second, the Fourth Circuit addressed the vitality of the new capital exception for the "sake of judicial economy," only after concluding that a reversal and remand were necessary on the classification issue alone. App. at 11a. Because the Fourth Circuit's decision to reverse and remand rested first on the Debtor's improper classification of unsecured claims in the Plan, the Court may decide not to reach the second question presented if this petition is granted. Cf. *Ahlers*, 485 U.S. at 203 n.3 (declining to resolve question of continued validity of new capital exception because it was not necessary "to resolve the instant dispute"). The Court should wait to review the viability of the new capital exception in a future case in which resolution of that issue is clearly required.

Finally, resolution of the second issue presented would have no effect on the outcome below. The Fourth Circuit held that even if the new capital exception survived and applied here, this Plan was still not confirmable because it was not fair and equitable to Travelers. App. at 16a. This alternative holding that the Plan was not fair and equitable, whether or not the new capital exception exists, was based on the recognition that satisfaction of the minimum requirements of 11 U.S.C. § 1129(b)(2) does not end the court's analysis on the "fair and equitable" issue. Instead, a court applying the fair and equitable standard must review "the entire plan in the context of the rights of the creditors under state law and the particular facts and circumstances" of the case. *In re D & F Construction, Inc.*, 865 F.2d 673, 675 (5th Cir. 1989) (technical compliance with the requirements of § 1129(b)(2) does not assure that a plan is fair and equitable); 5 *Collier on Bankruptcy*, ¶ 1129.03 at 1129-72 (15th ed. 1992) ("[A] plan which satisfies the standards

set forth in section 1129(b)(2) may or may not be 'fair and equitable' "). Based on the facts of this case, namely, that only Travelers was truly impaired under the Plan, the Fourth Circuit concluded that the Plan was not fair and equitable and could not be confirmed even if the new capital exception existed. App. at 16a. Resolution of the second issue presented in the petition, therefore, would have no effect on the validity of the judgment below. To insure vigorous advocacy on the issue, the Court should wait for a case in which resolution of the new capital exception issue bears on the outcome below.

For all these reasons, this case is not an appropriate vehicle for the Court to review the second question presented in the petition, even if it were ripe for review.

CONCLUSION

None of the factors ordinarily considered by this Court in agreeing to review a lower court decision are present in this case.

This Court should deny the requested writ.

Respectfully submitted,

THOMAS BARNES HENSON *
ALLEN KEITH ROBERTSON
ROBINSON, BRADSHAW & HINSON, P.A.
1900 Independence Center
101 North Tryon Street
Charlotte, North Carolina 28246
(704) 377-2536

JOHN C. MURRAY
THE TRAVELERS COMPANIES
2215 York Road, Suite 504
Oak Brook, Illinois 60521
(708) 574-2200

Attorneys for Respondent

August 14, 1992 * Counsel of Record